Montana Legislative Services Division
Office of Research and Policy Analysis

PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

March 9, 2010

TO: Rep. Dick Barrett and Rep. Franke Wilmer

FROM: Jeff Martin, Legislative Research Analyst

SUBJECT: Alternative Energy Generation Tax Credit

I am writing in response to your request for information on the alternative tax generation tax credit.

The credit was originally enacted as part of House Bill No. 755 (Chapter 648, Laws 1983). The legislation provided a tax credit for commercial systems that generate electricity by means of wind power. In 2001, Senate Bill No. 506 (Chapter 591, Laws 2001) was enacted to revise laws relating to alternative energy. Among other things, the legislation revised the credit contained in 15-32-402, MCA, to include generation from alternative energy sources and net metering systems. The legislation also clarified the policy statement under 15-32-401, MCA by substituting "alternative energy" for "wind energy". Those sections now read as follows:

> 15-32-401. **Purpose and statement of policy**. The purpose of this part is to encourage the development of the alternative energy industry in Montana without adversely affecting tax revenue received from existing economic activity in the state. Because of the alternative energy potential within the state, it is desirable to encourage alternative energy generation for the purpose of attracting alternative energy manufacturing industries to the state. It is also desirable for new or expanded industry to secure alternatively generated electricity on a direct contract sales basis without adversely affecting rates charged to other electricity users. (Emphasis added) Sound fiscal policy requires that encouragement be given to an alternative energy industry without subtracting from existing sources of revenue to the state.
>
> 15-32-402. **Commercial or net metering system investment credit -- alternative energy systems.** (1) An individual, corporation, partnership, or small business corporation as defined in 15-30-3301 that makes an investment of $5,000 or more in property that is depreciable under the Internal Revenue Code for a commercial system or a net metering system, as defined in 69-8-103,[1] that is located in Montana and that generates energy by means of an alternative renewable energy source, as defined in

[1] A net metering system is a facility for the production of electrical energy that: uses as its fuel solar, wind, or hydropower; has a generating capacity of not more than 50 kilowatts; is located on the customer-generator's premises; operates in parallel with the utility's distribution facilities; and is intended primarily to offset part or all of the customer-generator's requirements for electricity.

> 15-6-225,[2] is entitled to a tax credit against taxes imposed by 15-30-2103 or 15-31-121 in an amount equal to 35% of the eligible costs, to be taken as <u>a credit only against taxes due as a consequence of taxable or net income</u> (Emphasis added) produced by one of the following:
>
> (a) manufacturing plants located in Montana that produce alternative energy generating equipment;
>
> (b) a new business facility or the expanded portion of an existing business facility for which the alternative energy generating equipment supplies, on a direct contract sales basis, the basic energy needed; or
>
> (c) the alternative energy generating equipment in which the investment for which a credit is being claimed was made.
>
> (2) For purposes of determining the amount of the tax credit that may be claimed under subsection (1), eligible costs include only those expenditures that are associated with the purchase, installation, or upgrading of:
>
> (a) generating equipment;
>
> (b) safety devices and storage components;
>
> (c) transmission lines necessary to connect with existing transmission facilities; and
>
> (d) transmission lines necessary to connect directly to the purchaser of the electricity when no other transmission facilities are available.
>
> (3) Eligible costs under subsection (2) must be reduced by the amount of any grants provided by the state or federal government for the system.

Under subsection 15-32-402 (1)(a), a business entity that manufactures alternative energy equipment would be allowed the credit for investment in a commercial alternative energy system that is used in the manufacture of the alternative energy equipment. The credit is applied to net taxable income derived from the sale of the alternative energy equipment.

The language under subsection 15-32-402 (1)(b) is unclear. The lead-in to subsections (1)(a) through (1)(c) is "a credit only against taxes due as a consequence of taxable or net income produced by one of the following:". This means that a new or expanding business facility is eligible for the credit. However, the rest of the language in subsection (1)(b) implies that the business facility is a direct contract sales customer. I do not know whether that means that the business facility would have to purchase alternative energy from itself or related entity.

It is also unclear what constitutes a new or expanding business. The definition section under 15-31-124, MCA, for the new or expanded industry credit provides that "expanding" means to expand or diversify a present operation to increase total full-time jobs by 30% or more. The section also provides that a "new corporation" means a corporation engaging in manufacturing for the first time in this state. Those limitations do not appear to apply to a business entity under subsection (1)(b). It may be that a business facility that adds one employee could qualify for the credit.

---

[2] As provided in 15-6-225, MCA, alternative renewable energy includes but is not limited to solar energy, wind energy, geothermal energy, conversion of biomass, fuel cells that do not require hydrocarbon fuel, hydroelectric generators producing less than 1 megawatt, or methane from solid waste.

The language under subsection 15-32-402(1)(c) also seems a bit unclear. According to the Department of Revenue, the credit may be claimed by a business entity that invests in a commercial alternative energy system against taxable income attributable to the sale of the energy into the electric grid. However, the reference to 15-6-124, MCA, (see below) in the exclusion from other tax incentives under 15-32-405, MCA, implies that the alternative energy system used in a taxpayer's business would qualify for the credit. This subsection may also apply to a net metering system, however neither the statutes nor Department of Revenue rules specify how taxable net income from a net metering system is determined.

The maximum allowable alternative energy credit energy is 35% of eligible costs (see 15-32-402(2)). The amount of the credit is equal to the amount of income tax of the business entity attributable to alternative energy production provided that credit does not exceed the maximum allowable amount. For example, if a corporation invested $10,000 ($3,500 allowable credit) in alternative energy equipment, had taxable income of $100,000, and $46,000 of the taxable income amount was attributable to alternative energy production the amount of the credit for the tax year would be $3,105 ([$100,000 * 0.675 (corporation tax rate)] * 46%). The balance of the allowable credit is available for carryforward.

The amount of taxable income attributable to alternative energy production is determined by a three-factor formula similar to the three-factor formula contained in 15-31-305, MCA, as follows:

> ((Alternative energy property/total business property) + (alternative energy payroll/total business payroll) + (alternative energy sales/total business sales))/3

In general, the tax credit may be carried forward for 7 years. The credit may be carried forward for 15 years for a commercial system located within a Montana Indian reservation (see 15-32-404, MCA).

Section 15-32-405, MCA, provides that a taxpayer may not claim any other state energy or investment credit, including the new or expanded industry credit under 15-31-124 and 15-31-125, MCA. The property tax reduction allowed by 15-6-224, MCA, (see below) may not be applied to a facility for which a credit is claimed under Title 15, chapter 32, part 4, MCA.

Department of Revenue rules under ARM Title 42, chapter 4, subchapter 4 (ARM 42.4.4102 through 42.4.4104), provide general guidance for qualifying for electrical generation and transmission facilities for a property tax exemption, reduced tax rate, or credit (including the credit under 15-32-402, MCA). But is difficult to ascertain in all cases precisely who qualifies for the credit either under statute or administrative rule.

The alternative energy generation is apparently little used. It may be, as Rep. Dick Barrett points out, that the credit provisions are too vague. Or the credit may provide insufficient incentive for investment in alternative energy generation property, particularly if the alternative energy factors of property, payroll, and sales make up small percentages of the total factors. Or taxpayers are using other alternative energy production incentives (see below for two property tax exemptions).

Given the uncertainties about the credit, legislation may be needed to clarify the provisions.

Property Tax Exemptions for Alternative Energy Production

A business entity may qualify for the property tax exemption under 15-6-224, MCA, of up to $100,000 of the appraised value of a capital investment in a recognized nonfossil form of energy generation or low-emission wood or biomass combustion devices, as defined in 15-32-102, MCA. The exemption applies to a multifamily residential building or a nonresidential structure.

A business may qualify for the alternative renewable energy generation facilities exemption under 15-6-225, MCA. The exemption is for 5 years for a facility that has a nameplate capacity of less than 1 megawatt.[3]

I hope this information is useful. If you need more information, please contact me.

[3] In 2001, House Bill No. 600 (Chapter 579, Laws 2001) established a property tax exemption for electrical generation machinery and equipment owned or leased by the taxpayer for use in the taxpayer's business. The legislation provided for a sunset of the exemption on December 31, 2004.