NORTON ROSE FULBRIGHT

Investing in US Solar

US Tax Aspects for Japanese Investors

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Tax Credits Primary US Clean Energy Policy

- US Federal Government primarily promotes clean energy through tax credits
- Solar gets a 30% investment tax credit
  - Solar project costs $1 million earns $.3 million investment tax credit
  - Investment tax credit available in the first year the project is operational
  - Investment tax credit can be carried back 1-year and forward 20-years

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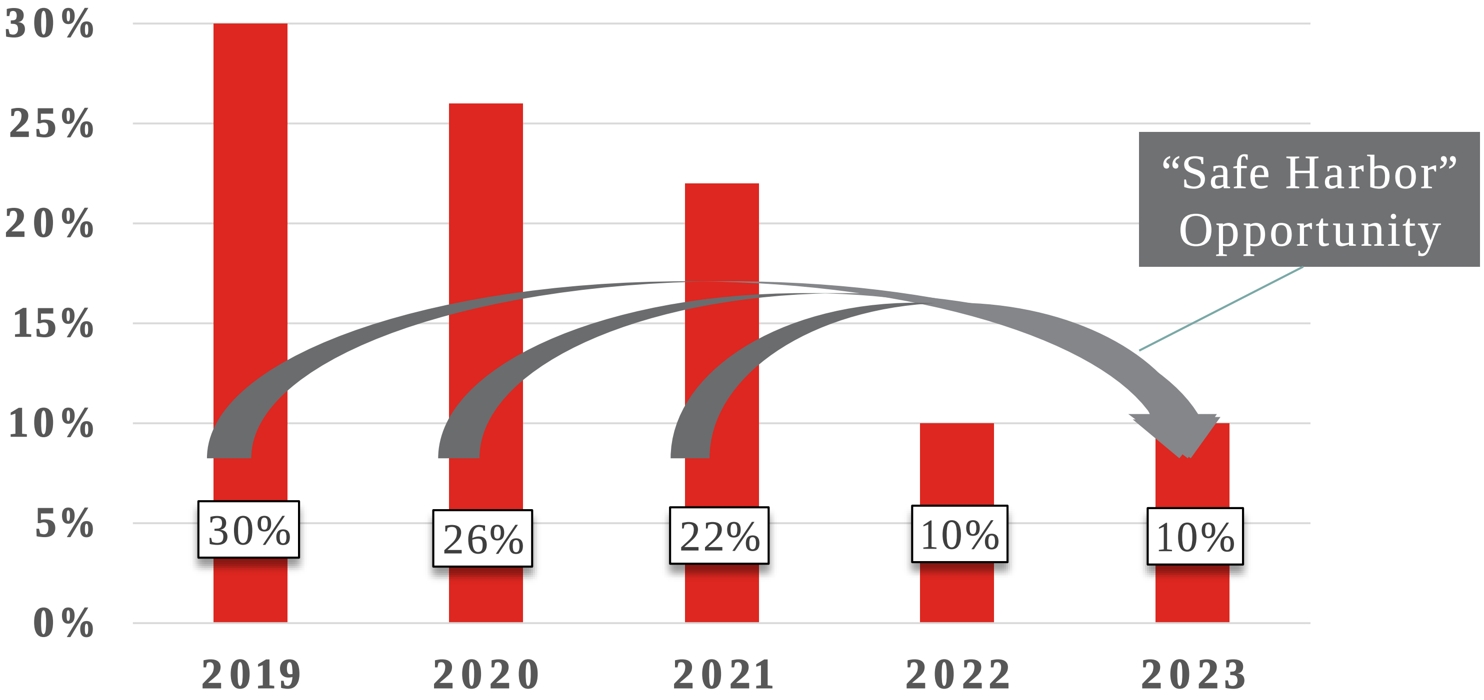
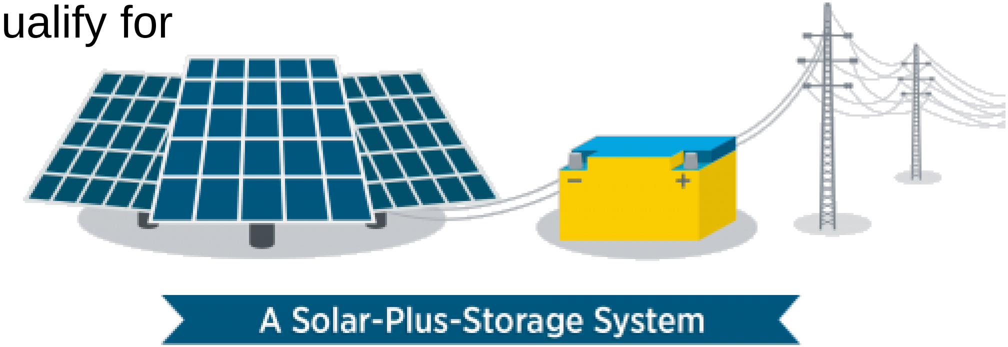
Solar Tax Credit to Decrease to 10%



Tax Credit for Batteries Charged by Solar

- Batteries charged more than 75% by solar qualify for the same investment tax credit as solar
- Opportunities for investment in retrofitting existing systems
- Solar and battery systems must have the same owner for the battery to qualify for the investment tax credit



Tax Depreciation: 100% Expensing

- Solar projects qualify for 100% expensing in the first year
- “Basis” that can be depreciated must be reduced by half of investment tax credit
- 100% expensing is not what is used for financial statement purposes (GAAP or IFRS)
- Bonus depreciation benefit starts to decline in 2023

Opportunities for Japanese Investors to Leverage Tax Equity Participation

Mitigate
US Tax liability

Deployment of
equipment,
services

Strategic
alignment with
US project
investments

Solar Tax Benefit Example

- Example: project costs $1,000,000
  - Investment tax credit is $300,000
  - Tax basis is $1,000,000 less 50% of tax credit or $150,000 so $850,000
  - Bonus depreciation tax benefit is $850,000 multiplied by federal corporate tax rate of 21% which is $178,500
  - Total federal tax benefit in the first year is $300,000 + $178,500 = $478,500

Federal government tax subsidy for solar is 47.8%

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But Taxpayers who can Benefit from Tax Credits and Depreciation is Limited

- In the 1980s, many individuals in the US were persuaded by brokers to invest in “tax shelters”
  - The US Internal Revenue Service ruled many of these “tax shelters” did not work
  - Congress passed strict rules to limit individuals from benefiting from tax credits and depreciation
- Tax credits and depreciation can only be used efficiently by profitable banks, insurance companies and public traded corporations
  - Creates too much “supply” of tax credits from projects and too little “demand”

But Taxpayers who can Benefit from Tax Credits and Depreciation is Limited (con't)

- A Japanese corporation with a US subsidiary paying US tax could be a tax equity investor
- Most solar sponsors cannot efficiently use tax credits and depreciation

Solution: tax equity investment structures

Tax Equity Investments

- Federal tax credits and depreciation cannot be “sold”
- To benefit from tax credits and depreciation must, generally, be an owner or a partner in the owner
- Most tax equity investors are not in the solar business
- Complex structures developed so tax equity investors can be a partner in the owner but with narrow operational involvement
- Tax equity utility scale solar returns 6.5% to 8.5% after tax
- Tax equity roof top solar: 9% to 12%+ after tax

Major tax equity investors

- JP Morgan
- US Bank
- Wells Fargo
- MUFG
- Goldman Sachs
- Berkshire Hathaway

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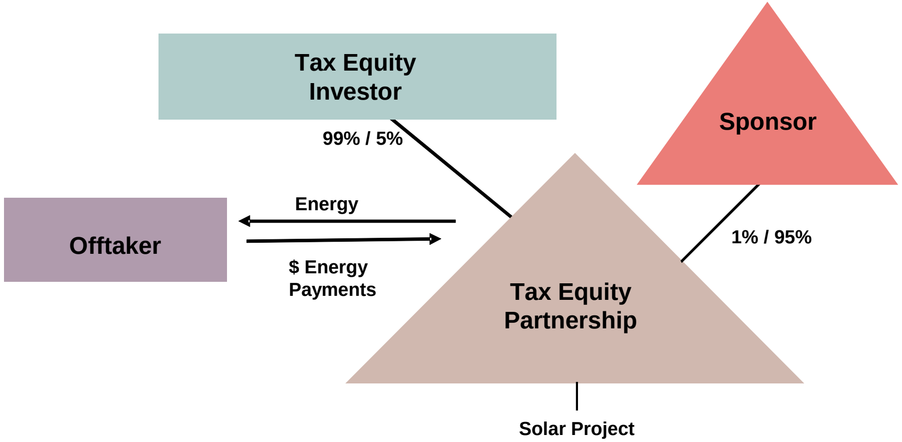
Tax Equity Structure: Partnership Flip



- Project is financed with sponsor equity and tax equity and, in some cases, debt
  - Tax equity investor typically makes an up-front investment of about 50% of project FMV in several installments. Before the project is operational, the tax equity investor must invest at least 20% of its total investment.
- Cash can be shared in different percentages than those above

Japanese Sponsor Equity Investor in US Solar

- Depreciation and tax credits are disqualified if a non-US investor directly owns equity in US solar project
- So a Japanese investor must invest through a US corporation, called a “blocker”
    - The US corporation is typically formed in Delaware or Nevada
    - It can be a US “limited liability company” (LLC) that elects to be taxed as a corporation
- Blocker corporation will pay 21% US federal corporate income tax and possibly state taxes

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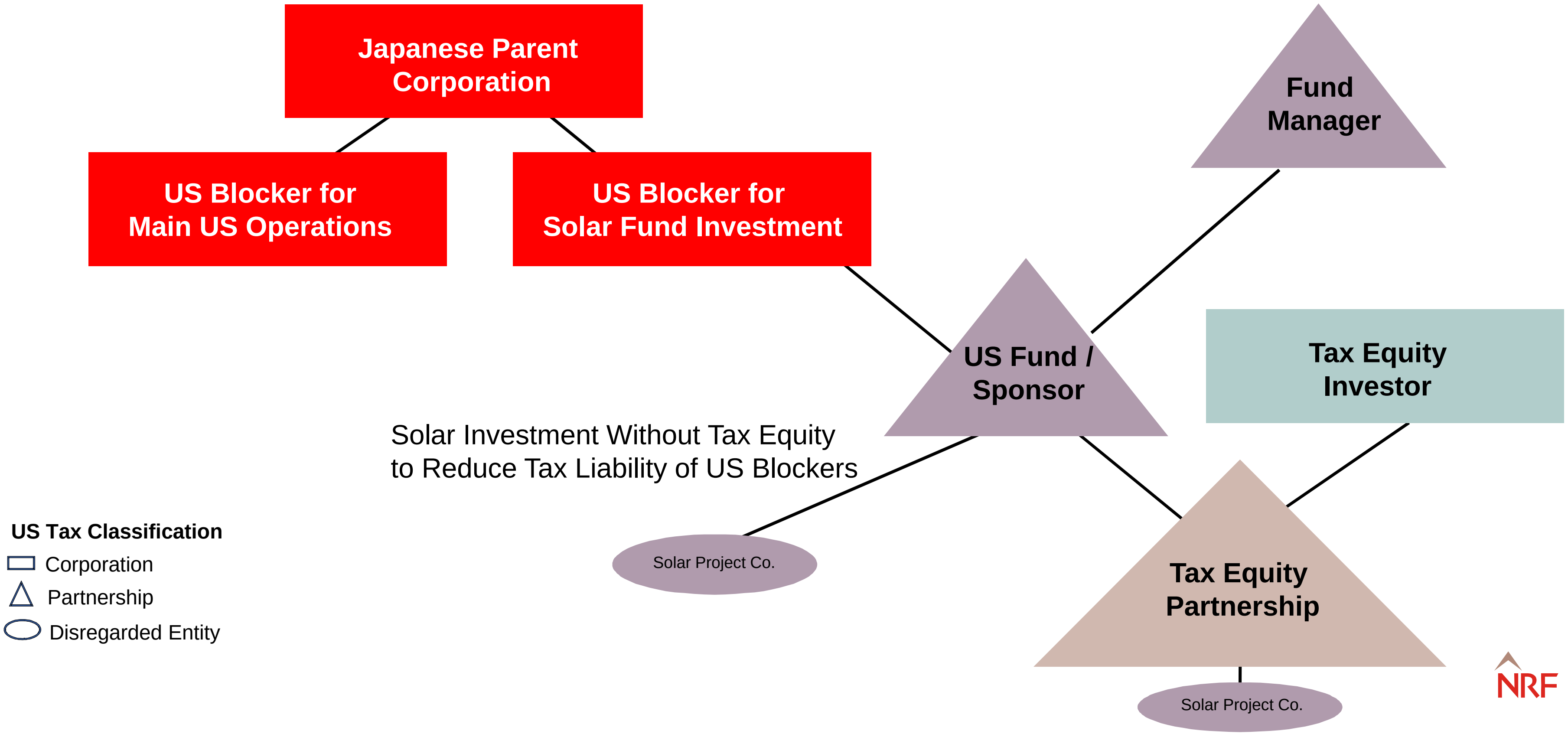
US Tax Benefits for Blocker Owned by Japanese Investor

- If blocker starts to have a large US tax liability, it could invest in solar projects directly or through a fund with no tax equity investor
- In some tax equity structures, there is more US tax depreciation than the tax equity investor can use
  - In some tax equity structures, this excess depreciation can be allocated to the blocker owned by a Japanese sponsor investor
- Blocker can “consolidate” for US tax purposes with Japanese parent’s other US operations and reduce the Japanese parent’s overall us tax liability

US Blocker Example: With and Without Tax Equity



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David advises clients on a wide range of US tax matters, with an emphasis on project finance and energy transactions. In addition, he advises clients on the tax aspects of the formation and structuring of private equity funds with particular expertise regarding renewable energy funds. David has extensive experience structuring tax-efficient transactions, such as flip partnerships, sale-leasebacks, pass-through leases and other structures, for the acquisition and financing of renewable energy assets that qualify for tax credits and other incentives.

Earlier in his career, David was the managing director and senior tax counsel at GE Energy Financial Services (GE EFS), one of the world's leading investors in energy projects. At GE EFS, David oversaw all of the tax aspects for more than US$21 billion in global energy projects from structuring transactions to accounting for taxes to formulating tax policy initiatives. During his tenure at GE EFS, the division's investments in wind, solar, hydro, biomass and geothermal power grew to US$6 billion, making GE EFS the largest tax-advantaged energy investor in the US. Before joining GE EFS, David was a tax lawyer at GE Capital and primarily focused on aircraft and equipment leasing and financing and asset acquisitions.