# Solar feeding into tax

by Ken Mansell, Tax Consultant

**Abstract:** Government subsidies provided to homeowners who install solar panels on the roofs of their homes may have an unexpected taxation outcome, namely, that the feed-in tariffs available can be assessable income. In this article, the author examines a number of private rulings on this subject issued by the Australian Taxation Office which show a trend towards solar feed-in tariffs being assessable income. Other rulings have concluded that payments or credits (net feed-in tariff) for very small-scale installations that will cover only the emissions of the household are not assessable income. There may be other problems. The value of renewable energy certificates given to the installer may be an assessable recoupment. Capital gains tax and goods and services tax consequences may also ensue. On the other hand, if the feed-in tariff is assessable, the taxpayer may be able to claim deductions, but any depreciation may be limited by installation rebates.

## Introduction

Over the last few years, governments have been providing money to people who install solar panels on the roof of their home. They have done this irrespective of the fact that "[t]he implicit abatement subsidy for the programs that subsidise solar PV [photovoltaic] … was estimated to be in the range of A$431/t $CO_2$–A$1043/t $CO_2$".[1] This fact makes rooftop solar one of the least effective uses of money to reduce $CO_2$ by governments — given that the world carbon price is currently estimated to be around $50/t $CO_2$ and Australia is looking to introduce a price on carbon of around $23/t $CO_2$.

So why have so many people rushed to put solar on their roof if it is a highly inefficient way to reduce $CO_2$? The answer can only be the money. However, it appears that many people who think they have found the golden goose on their roof have forgotten that the taxman wants his part — that the feed-in tariffs available can be assessable income.

## ATO rulings

While the Australian Taxation Office (ATO) has not released a public ruling on the assessability of solar feed-in tariffs, it has numerous private rulings on its website and these show a trend towards many solar feed-in tariffs being assessable income.

Numerous private rulings by the ATO[2] have concluded that the feed-in tariff is assessable income. Other rulings[3] have concluded that payments or credits (net feed-in tariff) for very small-scale PV that will only cover the emissions of the household and nothing more are not assessable income.

Assessable income on the feed-in tariff may not be the only problem. Most of the private rulings also remind the owner that:

- Under many of these schemes, the government also makes payments to the installer on the home owner's behalf to bring down the costs that they had to pay. This payment is made because the government gives the owner renewable energy certificates (RECs) for installing solar and the owner assigns them to the installer to get the discounted installation price. These private rulings make it clear that, in many cases, the value of these RECs given to the installer (the amount of the discount) is an assessable recoupment and must also be included in the home owner's assessable income. Ouch!
- Capital gains tax and goods and services tax consequences may also apply. Goods and services tax may only apply if the owner is required to register (turnover above $75,000). However, the main residence exemption under Div 118 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) will not apply to the solar system on the roof when the property is sold. The home owner may therefore need to apportion the amount received on any future sale.

## ATO reasoning

There are two provisions that the ATO focuses on in its rulings about the assessability of the feed-in tariffs. These are:

- s 6-5(1) ITAA97 — ordinary income means income "according to ordinary concepts"; and
- s 6-5(4) ITAA97 — when working out whether you have derived an amount of ordinary income and (if so) when you derived it, you are taken to have received the amount as soon as it is applied or dealt with in any way on your behalf or as you direct.

The private rulings summarise the case law in relation to ordinary income into the following long-held factors:

- whether the payment is the product of any employment, services rendered or any business;
- the quality or character of the payment in the hands of the recipient;
- the form of the receipt, that is, whether it is received as a lump sum or periodically; and
- the motive of the person making the payment, but noting that this latter factor is rarely decisive as a mix of motives may exist.

Some of the private rulings look at IT 2167 on rental properties and the discussion in this public ruling about when amounts received will be considered income and when they will be considered to be in the nature of family or domestic arrangements. They conclude from this analysis that there are four important issues:

(1) the terms of the arrangement with the electricity retailer and, in particular, any

requirement on the retailer to buy all electricity that is generated from the system (as occurs under a gross feed-in tariff scheme);

(2) the feed-in tariff payments and whether they are considered to represent a return on your investment in the solar system;

(3) whether there is a realistic opportunity for you to profit from the arrangement; and

(4) the regularity of payments/credits received from the feed-in tariffs such that they can be relied on.

Issues 1 and 4 will suggest that any feed-in tariff is assessable income for all of the current feed-in tariff arrangements. The way that these systems have been marketed would suggest that these feed-in tariffs are assessable income under issue 2. So that just leaves issue 3, that is, whether there is a realistic opportunity to profit from the arrangement. It is this issue that appears to be the main difference between the private rulings that have held the feed-in tariffs to be assessable income and the private rulings that have held the feed-in tariffs to not be assessable income.

If you thought the fact that the feed-in tariff is assessable is bad, the worst is yet to come. The private rulings remind us that, under s 20-A ITAA97, certain recoupments are assessable, including a grant in respect of a loss or an outgoing.

The private rulings conclude that the "government rebates on installation", as they are often called, are assessable recoupments and so are to be included in assessable income. However, as these systems may be depreciated under Div 40 ITAA97, the amount of the recoupment that is assessable in each year will be the amount of any depreciation claimed (s 20-40 ITAA97).

This means that, although the tariff might be assessable income, you may not get any depreciation deductions for many years due to the installation rebates from the government. Note that, in TR 2010/2, the effective life of solar power generating system assets on residential property is 20 years.

## Final thoughts

So what can we draw from these rulings? To quote from private rulings 101168079104 and 1011733968747:

- "There is a realistic opportunity to profit from the arrangement" — feed-in tariffs are assessable income; and
- "There is no realistic opportunity for you to profit from the arrangement" — feed-in tariffs are not assessable income.

In layman's terms, if the rooftop solar system looks big enough to make a profit, then the whole payment or credit on your utility bill is taxable. What is big enough? Again, from the private rulings, we can see that a 2.5 KV system can be seen as small enough to just cover the household's emissions.[4] However, get a 7.5KV system and tax will be payable.[5]

Remember, if the feed-in tariff is assessable, you may be able to claim deductions (interest, repairs etc), but any depreciation may be limited by installation rebates.

Three last comments:

1. Some have argued that a net feed-in tariff (one that reduces your electricity bill before giving you any payment) is non-assessable but a gross feed-in tariff is assessable. This cannot be concluded from the private rulings. In the private rulings, where net feed-in tariffs were found to be non-assessable, the reasoning clearly states that the size of the solar PV installed was only to cover the household's $CO_2$ emissions, so it was likely that there would be no net tariff payments. And we must remember that, under s 6-5(4) ITAA97, a taxpayer is taken to derive income as soon as it is applied or dealt with in any way on their behalf or as they direct. Therefore, offsetting the amount against your other utility bills will not stop an amount from being assessable.

2. Others have argued that, if the property is used for income-producing activities, the feed-in tariff is assessable but not if the house is used for private and domestic purposes. Again, this cannot be concluded from the private rulings. Private ruling 101168079104 is about solar PV on the roof of a rental property and the reasoning is the same as the private dwelling private rulings.

3. It does appear that many people are just ignoring the tax issues, but I doubt it will go away. The ATO could easily ask each state and territory for a list of people who are getting the feed-in tariff or RECs and match that to tax returns.

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References

1 Australian Government, *Carbon Emission Policies in Key Economies*, Productivity Commission Research Report, 9 June 2011.

2 See private rulings 1011739693623 (PV on strata units), 101157831449 (PV on a farm house), and 1011659307333 (PV on a normal private residence).

3 For example, private rulings 1011733968747 and 1011677090553.

4 See private ruling 1011733968747.

5 See private ruling 1011676003047.