APA Accounting and Finance Workshop

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Agenda

- **Leases (ASC 842)**
- **Leases (ASU 842) Land Easements**
- **Revenue from Contracts With Customers (ASC 606)**
- **Compensation—Retirement Benefits (ASC 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost**
- **Tax Reform**
- **IRS Letter Ruling on Batteries and Solar**

Leases (ASC 842)

Lessee Model Approaches

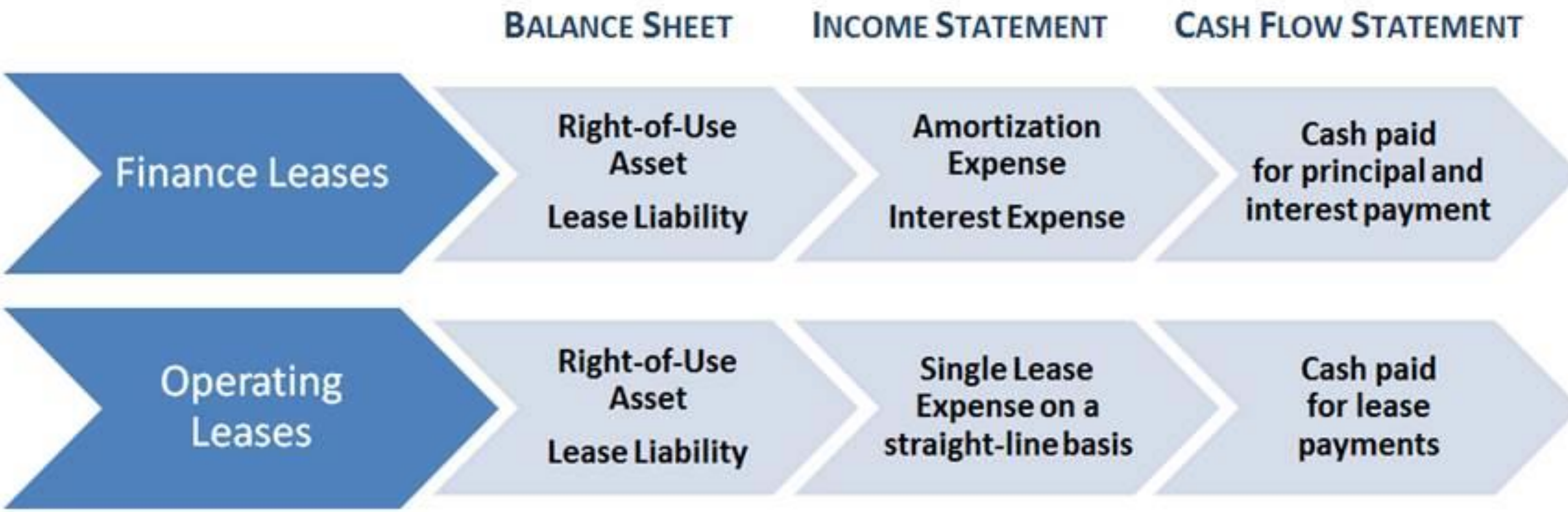
All leases (more than 12 months) are recognized on the lessee's balance sheet

Current U.S. GAAP (IFRS)	IASB	FASB
Capital (Finance) Leases	Type A	Type A
Operating Leases	Type A	Type B

All leases are the same.

Not all leases are the same. Classification is based on existing U.S. GAAP/IFRS.

Lessee Accounting Overview (ASC 842)



- **Indicia of control: (The first two are mandatory)**
  - Customer has **right to obtain substantially all of the economic benefits from use of the asset throughout the period of use?**
  - Customer has **the right to direct how and for what purpose the identified asset is used throughout the period of use?**
  - Customer has **the right to operate the asset throughout the period of use without the supplier having the right to change those operating instructions**?
  - **Did the customer design the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use?**

Leases – Practical Expedients

Entities also would have the option to elect to apply the following relief; however, it is all or nothing, i.e., if elected, it must be applied to all leases:

- **An entity need not reassess whether any expired or existing contracts are or contain leases.**
- **An entity need not reassess the lease classification for any expired or existing leases (that is, all existing leases that were classified as operating leases in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as finance leases).**
- **An entity need not reassess initial direct costs for any existing leases.**

Leases – FASB Proposed Accounting Standard Update

On January 5, 2018, the FASB issued a Proposed ASU intended to reduce costs and ease implementation of the Leases standard for financial statement preparers.

The proposed ASU would simplify transition requirements and, for lessors, provide a practical expedient for the separation of nonlease components from lease components. Specifically, the amendments would:

- Add an option for transition to ASU No. 2016-02, Leases (Topic 842), that would **permit an organization to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements.**
- Add a practical expedient that would permit lessors to not separate nonlease components from the associated lease components if certain conditions are met. This practical expedient could be elected by class of underlying assets; if elected, certain disclosures would be required.

The comment deadline is February 5, 2018.

Leases – Contract for Energy/Power Containing a Lease

- A utility company (Customer) enters into a contract with a power company (Supplier) to **purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract, and Supplier has no substitution rights. The solar farm is owned by Supplier, and the energy cannot be provided to Customer from another asset. Customer designed the solar farm before it was constructed—Customer hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Supplier is responsible for building the solar farm to Customer's specifications and then operating and maintaining it. There are no decisions to be made about whether, when, or how much electricity will be produced because the design of the asset has predetermined these decisions.** Supplier will receive tax credits relating to the construction and ownership of the solar farm, while Customer receives renewable energy credits that accrue from use of the solar farm.

Leases – Contract for Energy/Power Containing a Lease

- The contract contains a lease.
- **Customer has the right to use the solar farm for 20 years.**
- **There is an identified asset** because the solar farm is explicitly specified in the contract, and Supplier does not have the right to substitute the specified solar farm.
- Customer has the right to control the use of the solar farm throughout the 20-year period of use because:
  – a. **Customer has the right to obtain substantially all of the economic benefits from use of the solar farm over the 20-year period of use.**

Leases – Contract for Energy/Power Containing a Lease

- **Customer has use of the solar farm; it takes all of the electricity produced by the farm over the 20-year period of use as well as the renewable energy credits that are a by-product from use of the solar farm.** Although Supplier will be receiving economic benefits from the solar farm in the form of tax credits, those economic benefits relate to the ownership of the solar farm rather than the use of the solar farm and, thus, are not considered in this assessment.
- b. **Customer has the right to direct the use of the solar farm.** Neither Customer nor Supplier decides how and for what purpose the solar farm is used during the period of use because those decisions are predetermined by the design of the asset (that is, the design of the solar farm has, in effect, programmed into the asset any relevant decision-making rights about how and for what purpose the solar farm is used throughout the period of use). Customer does not operate the solar farm; Supplier makes the decisions about the operation of the solar farm. However, Customer's design of the solar farm has given it the right to direct the use of the farm (as described in paragraph 842-10-15-20(b)(2)). Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, Customer's control over that design is substantively no different from Customer controlling those decisions.

Leases – Contract for Energy/Power Does Not Contain a Lease

- **Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years.** The power plant is owned and operated by Supplier. **Supplier is unable to provide power to Customer from another plant. The contract sets out the quantity and timing of power that the power plant will produce throughout the period of use, which cannot be changed in the absence of extraordinary circumstances (for example, emergency situations).** Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. **Supplier designed the power plant when it was constructed some years before entering into the contract with Customer; Customer had no involvement in that design.**
- The contract does not contain a lease.

Leases – Contract for Energy/Power Does Not Contain a Lease

- **There is an identified asset** because the power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.
- **Customer has the right to obtain substantially all of the economic benefits** from use of the identified power plant over the three-year period of use.
- **Customer will take all of the power produced by the power plant over the three-year term of the contract.**
- **However, Customer does not have the right to control the use of the power plant because it does not have the right to direct its use.**

Leases – Contract for Energy/Power Does Not Contain a Lease

- **Customer does not have the right to direct how and for what purpose the plant is used.** How and for what purpose the plant is used (that is, whether, when, and how much power the plant will produce) are predetermined in the contract. **Customer has no right to change how and for what purpose the plant is used during the period of use, nor does it have any other decision-making rights about the use of the power plant during the period of use** (for example, it does not operate the power plant) and did not design the plant. **Supplier is the only party that can make decisions about the plant during the period of use by making the decisions about how the plant is operated and maintained.** Customer has the same rights regarding the use of the plant as if it were one of many customers obtaining power from the plant.

Leases – Contract for Energy/Power Containing a Lease

- **Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years. The contract states that Customer has rights to all of the power produced by the plant** (that is, Supplier cannot use the plant to fulfill other contracts).
- **Customer issues instructions to Supplier about the quantity and timing of the delivery of power. If the plant is not producing power for Customer, it does not operate.**
- **Supplier operates and maintains the plant on a daily basi**s in accordance with industry-approved operating practices.
- The contract contains a lease. Customer has the right to use the power plant for 10 years.
- **There is an identified asset.** The power plant is explicitly specified in the contract, and **Supplier does not have the right to substitute the specified plant.**

Leases – Contract for Energy/Power Containing a Lease

- Customer has the right to control the use of the power plant throughout the 10-year period of use because:
  - a. **Customer has the right to obtain substantially all of the economic benefits from use of the power plant over the 10-year period of use. Customer has exclusive use of the power plant; it has rights to all of the power produced by the power plant throughout the 10-year period of use.**
  - b. **Customer has the right to direct the use of the power plant.** Customer makes the relevant decisions about how and for what purpose the power plant is used because it has the right to determine whether, when, and how much power the plant will produce (that is, the timing and quantity, if any, of power produced) throughout the period of use. **Because Supplier is prevented from using the power plant for another purpose, Customer's decision making about the timing and quantity of power produced, in effect, determines when and whether the plant produces output.**

Leases – Contract for Energy/Power Containing a Lease

- Although the operation and maintenance of the power plant are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the power plant is used.
- Consequently, **Supplier does not control the use of the power plant during the period of use.**
- Instead, **Supplier's decisions are dependent on Customer's decisions about how and for what purpose the power plant is used.**

Leases – Example: —Initial and Subsequent Measurement of the Right-of-Use Asset and the Lease Liability

- **Lessee enters into a 10-year lease of an asset, with an option to extend for an additional 5 years. Lease payments are $50,000 per year during the initial term and $55,000 per year during the optional period, all payable at the beginning of each year. Lessee incurs initial direct costs of $15,000.**
- At the commencement date, Lessee concludes that **it is not reasonably certain to exercise the option to extend the lease** and, therefore, **determines the lease term to be 10 years.**
- **The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5.87 percent, which reflects the fixed rate at which Lessee could borrow a similar amount in the same currency, for the same term, and with similar collateral as in the lease at the commencement date.**

Leases – Example: —Initial and Subsequent Measurement of the Right-of-Use Asset and the Lease Liability

- At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, and **measures the lease liability at the present value of the remaining 9 payments of $50,000, discounted at the rate of 5.87 percent, which is $342,017.**
- **Lessee also measures a right-of-use asset of $407,017 (the initial measurement of the lease liability plus the initial direct costs and the lease payment for the first year). ($342,017+$50,000+$15,000)**
- During the first year of the lease, Lessee recognizes lease expense depending on how the lease is classified.

Leases – Example: —Initial and Subsequent Measurement of the Right-of-Use Asset and the Lease Liability

If the Lease Is Classified as a Finance Lease

- **Lessee depreciates its owned assets on a straight-line basis. Therefore, the right-of-use asset would be amortized on a straight-line basis over the 10-year lease term. The lease liability is increased to reflect the Year 1 interest on the lease liability in accordance with the interest method. As such, in Year 1 of the lease, Lessee recognizes the amortization expense of $40,702 ($407,017 ÷10) and the interest expense of $20,076 (5.87% × $342,017).**
- **At the end of the first year of the lease, the carrying amount of Lessee's lease liability is $362,093 ($342,017 + $20,076), and the carrying amount of the right-of-use asset is $366,315 ($407,017 – $40,702).**

Leases – Example: —Initial and Subsequent Measurement of the Right-of-Use Asset and the Lease Liability

If the Lease Is Classified as an Operating Lease

- Lessee determines the cost of the lease to be \$515,000 (sum of the lease payments for the lease term and initial direct costs incurred by Lessee). The annual lease expense to be recognized is therefore \$51,500 (\$515,000 ÷ 10 years).
- At the end of the first year of the lease, the carrying amount of Lessee's lease liability is \$362,093 (\$342,017 + \$20,076), and the carrying amount of the right-of-use asset is \$375,593 (the carrying amount of the lease liability plus the remaining initial direct costs, which equal \$13,500).

Effective Date: Leases (ASC 842)

- 2019 for public business entities and certain other SEC filers…fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.
- **2020 for all other entities…fiscal years beginning after December 15, 2019**, and interim periods within fiscal years beginning after December 15, 2020.
- Early adoption is permitted.

Leases (ASC 842) Land Easements

Leases – Land Easements

On January 25, 2018, the FASB issued an Accounting Standards Update intended to clarify the application of the new leases guidance to land easements.

<u>The new ASU also would permit an entity to elect a practical expedient to not apply the new standard to land easements that exist or expired before the effective date of the new lease standard – even if those land easements were not previously assessed under the old lease accounting.</u>

Once adopted, the new standard would apply prospectively to all new (or modified) land easements and an entity would have to determine whether the arrangement should be accounted for as a lease.

Leases – Land Easements

In our comment letter, **we suggested that the language of the practical expedient should be modified to make it absolutely clear that only those land easements which have previously been accounted for as leases are excluded from consideration for the application of the practical expedient.**

We also believe that the **FASB should explicitly state that the Exposure Draft is not intended to modify an entity's accounting treatment of land easements which do not meet the criteria for lease accounting under Topic 842.**

It is possible that some may interpret the Exposure Draft to require that land easements which are not leases be accounted for only as an intangible asset.

We believe that the final Accounting Standards Update should state entities may continue to apply other Topics within the FASB Accounting Standards Codification, such as Topic 350, Intangibles–Goodwill and Other, or Topic 360, Property, Plant, and Equipment to land easements which are not leases.

Revenue from Contracts With Customers (ASC 606)

Revenue from Contracts With Customers (ASC 606)

- On May 28, 2014, the FASB issued a new accounting standards update, ASU 2014-09 Revenue From Contracts with Customers.
- The core principle of this proposed guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Revenue from Contracts With Customers (ASC 606)

- To achieve that core principle, an entity would apply all of the following steps:

  Step 1: **Identify the contract with a customer.**

  Step 2: **Identify the separate performance obligations in the contract.**

  Step 3: **Determine the transaction price.**

  Step 4: **Allocate the transaction price to the separate performance obligations in the contract.**

  Step 5: **Recognize revenue when (or as) the entity satisfies a performance obligation**

Revenue from Contracts With Customers (ASC 606)

- **For nonpublic entities, the amendments are effective for annual reporting periods beginning after December 15, 2018** (with interim periods beginning one year later).
- **For public business entities**, certain not-for-profit entities, and certain employee benefit plans, the effective date for ASC 606 is ***<u>annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017</u>***.

Revenue From Contracts with Customers (ASC 606)

Contributions in Aid of Construction

- This implementation issue discusses the application of Topic 606 to regulated utility accounts for Contributions in Aid of Construction (CIAC).

Submitted to AICPA RRWG

Revenue From Contracts with Customers (ASC 606)
Contributions in Aid of Construction

- With respect to CIAC, the Group looked at three scenarios:
- **Construction where the contracting party doesn't become a customer** – such as government request to underground lines in a historic district – not in scope
- **Contract to hook up a customer and they take service afterward under the tariff with no contract** – the Group is arguing not in scope, RRWG (the overall AICPA working group on revenue recognition) initially talked about "implied" contract with customer

Revenue From Contracts with Customers (ASC 606)
Contributions in Aid of Construction

- Same as the second scenario except there is also a **contract with the customer to take service for some term** – the Group argued for current accounting, RRWG struggling to see why this isn't a contract with a customer and the CIAC payment is additional consideration for future service.

Revenue From Contracts with Customers (ASC 606)

Contributions in Aid of Construction

- And here is James Barker’s [Deloitte & Touche…co-chair of RRWG) summary of our technical inquiry with FASB staff:
- **The FASB staff said they would not object to the industry’s position that CIAC is outside the scope of ASC 606 and therefore today’s practice of reducing PP&E by the amount of CIAC received can continue.**

Revenue From Contracts with Customers (ASC 606)

Contributions in Aid of Construction

For now, I think we should view this answer as **applying to regulated entities where the CIAC amounts are prescribed by regulation (or Board Policy) (i.e. not subject to negotiation between buyer and seller). Electric cooperatives are regulated by their boards.**

Compensation—Retirement Benefits (ASC 715):

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

Compensation—Retirement Benefits (ASC 715):

- ASU 2017-7 —Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost
- In March 2017, the FASB amended the Accounting Standards Codification by issuing ASU 2017-7 **The new standard will not apply to the NRECA Retirement Security (R&S) Plan as that plan is accounted for under the multi-employer pension plan rules which essentially place the plan participants on the cash basis for their contributions to the plan. The new ASU will, however, apply to postretirement benefit plans of electric cooperatives.**

Compensation—Retirement Benefits (ASC 715):

The amendments in this Update **require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost** as defined in paragraphs 715-30-35-4 and 715-60- 35-9 of the accounting standards codification **are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented.**

Compensation—Retirement Benefits (ASC 715):

If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be **appropriately described**. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be **disclosed**.

Compensation—Retirement Benefits (ASC 715):

The amendments in this Update also allow **only the service cost component to be eligible for capitalization when applicable** (for example - a self-constructed asset).

Compensation—Retirement Benefits (ASC 715):

- ***Most electric cooperatives include the entire net periodic benefits cost in their labor distribution. The potential impact of the ASU upon electric cooperatives will vary, depending on what proportion the service cost component is to the total net periodic benefits cost. The larger the service cost component, the less impact the ASU will have on the income statement when the non-service cost components of net periodic benefits cost which may have been previously capitalized are expensed.***

Compensation—Retirement Benefits (ASC 715):

- ***Electric cooperatives may have to do two labor distribution calculations – one for service cost which will get expensed and capitalized, and one for the other components of net periodic benefits cost (the interest cost component, the expected return on plan assets for the period, the gain or loss component, the prior service cost or credit component, the transition asset or obligation component and the gain or loss recognized due to settlements or curtailments.) which will get expensed.***
- ***The ASU requires that the elements of post-retirement benefit cost other than the service cost component should be disclosed in a single line item (if material) and placed below the line in non-operating income. This result could create a variance with RUS which has historically required that these costs be included in the labor distribution for capital and expense projects.***

Compensation—Retirement Benefits: FERC

- On December 28, 2017, FERC issued guidance to their jurisdictional utilities on the issues raised in ASC 715.
- Regarding Account 926, Employee Pensions and Benefits, FERC concluded that the pension and PBOP expenses should be recorded to the respective jurisdictional account without separation of the various components making up the pension and PBOP costs and be included in the calculation of Net Utility Operating Income.

Compensation—Retirement Benefits: FERC

- On the issue of capitalization of pension and PBOP costs, FERC concluded that jurisdictional entities may continue to capitalize the service cost component and non-service cost components of pension and PBOP costs as it has traditionally been the widely accepted practice, or they may elect to capitalize only the service cost component of pension and PBOP costs, as prescribed by ASU No. 2017-07. Both methods are appropriate and are not precluded by the Commission's accounting requirements but whichever method is chosen must be used consistently for ratemaking in future years.

Compensation—Retirement Benefits: FERC

- Regarding disclosures and future filings, FERC concluded that jurisdictional entities should disclose any changes in accounting practice in response to ASU No. 2017-7 in their respective FERC Forms filed to the Commission quarterly and annually, within the Notes to the Financial Statements. Disclosures should include potential rate impacts resulting from these changes, including the effects on rate base and current period expenses. Jurisdictional entities should also make similar disclosures on future rate filings, as applicable.

Effective Date: Compensation—Retirement Benefits (ASC 715)

- 2018 for public business entities…fiscal years beginning after December 15, 2017, including interim periods within those fiscal years.
- **2019 for other entities…fiscal years beginning after December 15, 2018**, and interim periods within fiscal years beginning after December 15, 2019.
- Early adoption is permitted (as of the beginning of an annual period in which no interim or annual financial statements have been issued or made available for issuance.

Tax Reform


What happened?!?
Congress "simplified" the tax code again.

The Tax Cuts and Jobs Act of 2017

- **Maintained current tax treatment of not-for-profit cooperatives** - Co-ops are able to keep their not-for-profit status
- **Maintained current tax treatment of entities created and owned by electric cooperatives*****
- **Maintained current tax treatment of 401(K) Plan contributions** - Allows employees to save for retirement with pre-tax dollars
- **Interest Expense** - Interest for business purposes is generally deductible in the taxable year in which the interest is paid or accrued. Any interest that is disallowed may be carried forward indefinitely, and any excess limitation may be carried forward for three years. Senate amendment adopted in final report that the limitation(i.e. 30% of adjusted taxable income), which does not apply to certain regulated public utilities, also does not apply to electric cooperatives. **(Favorable - eliminates negative impact on taxable co-ops)**

The Tax Cuts and Jobs Act of 2017

- **Modification of the energy investment tax credit** - The current Commercial Investment Tax Credit (Section 48) for geothermal energy, solar energy, qualified fuel cell, and qualified small wind energy property have expired. House Provisions **Not Adopted Unfavorable (May Be in a later Extenders Package) – Still under current law.**
- **Termination of private activity bonds** - Private Activity Bond - Tax-exempt bonds issued by or on behalf of local or state government to provide special financing benefits for qualified projects. The PAB results in reduced financing costs because of the exclusion of federal income tax. **No Provisions Favorable**

The Tax Cuts and Jobs Act of 2017

- **Repeal of tax credit bonds** - Current statute authorizes Clean Renewable Energy Bonds (CREBS) available to co-ops. **House Provisions Adopted Unfavorable**
- **Retirement Savings – 401(K) and 457(b) Defined Contribution Plans Section 1501 – 1506**. No changes to current law 457(b) or 401(k) limits, pre or post tax (Roth) deferrals. There are some changes to hardship distributions and distributions at age 59 ½ from pension plans and 457 plans, but overall the big concern on "changing the current law tax treatment of 401(k) Contributions" has been avoided. **(Favorable – No changes to current tax treatment on contributions in H.R. 1) Senate Provisions Favorable**

The Tax Cuts and Jobs Act of 2017

- **Retirement Savings –Defined Benefit Plans (like RS Plan) Non-Discrimination Rules**.
- Section 1506. Modification of nondiscrimination rules to protect older, longer service participants - H.R. 1 fixes a growing problem for electric co-ops both in the Retirement Security Plan or sponsoring a stand-alone defined-benefit plan that have "closed" their plans to new employees, but continue to provide benefits for employees in the plan before the "closed" date. **Under current IRS "Non-Discrimination" rules, co-ops that "closed" their plans to new employees will eventually be forced to close their plans completely for all employees simply because long-service employees in the plan are paid more than new employees being hired. This doesn't make sense.** The House Tax Bill solves this problem completely for all co-ops in the NRECA RS plan, and any co-op with its own defined benefit pension plan, by including identical language from the Senate Finance-passed bill from September of 2016 that we sent letters of support on last year. (Favorable – Included in H. R. 1) **No Provision Unfavorable**

The Tax Cuts and Jobs Act

Significant Corporate Changes:

- Corporate Tax Rate reduced to 21%
- Alternative Minimum Tax Repealed
- Net Operating Losses Modified
- New Interest Expense Limitation

The Tax Cuts and Jobs Act

Net Operating Loss Modifications:

- Net operating losses generated in years after 2017 will have an indefinite carry-forward period.
- However, use of losses are limited to 80% of taxable income.
- These indefinite loss carry-forwards are still subject to a valuation allowance for financial statement purposes.
- Existing losses for years 2017 and prior remain subject to the 20 yr carry-forward and offset 100% of taxable income.

The Tax Cuts and Jobs Act

Interest Expense Limitation:

- Deduction for interest expense is limited to 30% of EBITDA for 2018-2021 and 30% of EBIT in 2022 forward.
- Interest expense not allowed can be carried forward indefinitely, subject to a valuation allowance for financial statement purposes.
- Electric Cooperatives are generally exempt from this limitation, however non-cooperative subsidiaries of Electric Cooperatives are not exempt.

The Tax Cuts and Jobs Act

<u>Additional Significant Corporate changes</u>:

- Self-created property (patents, inventions, etc.) excluded from capital asset category.
- Luxury automobile depreciation limits increased.
- Computers removed from listed property.

The Tax Cuts and Jobs Act

Additional Significant Corporate changes:

- No deduction for settlement amounts paid for sexual harassment subject to nondisclosure
- Employee achievement awards changes
- Tax-exempt organizations – Excise tax on compensation to covered employee over $1 Million
- UBIT separately computed for each trade or business activity

The Tax Cuts and Jobs Act

Other IRS Proposed Regulations:

- Deductibility of state and local tax payments – Federal law will control characterization of payments regardless of state law.
- Requirement that all information returns, regardless of type, be taken into account for the 250 return threshold for electronic filing of documents. Would be effective for all returns filed after December 31, 2018.

The Tax Cuts and Jobs Act

Suspension of exclusion for qualified moving expense reimbursements:

- Under pre-enactment law, qualified moving expense reimbursements were excludable from an employee's gross income and from the employee's wages for employment tax purposes.
- Such expenses included amounts received (directly or indirectly) from an employer as payment for (or reimbursement of) expenses that would have been deductible as moving expenses if directly paid or incurred by the employee.

The Tax Cuts and Jobs Act

<u>Suspension of exclusion for qualified moving expense reimbursements</u>:

- The new law suspends the exclusion from gross income and wages for qualified moving expense reimbursements for years 2018–2025.
- The effective date is for tax years beginning after December 31, 2017.

The Tax Cuts and Jobs Act of 2017

- **Section 118 changes: federal, state and local grants are now taxable income to corporations.**
- Under the Act, section118 is amended to provide that the term “contribution to the capital of the taxpayer” does not include “any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).”
- Accordingly, contributions of money or property to a corporation by a governmental entity will be includible in gross income (unless another exclusion applies).

The Tax Cuts and Jobs Act of 2017

- **Section 118 changes: federal, state and local grants are now taxable income to corporations.**
- Note that this may include FEMA funds(unless FEMA funds are more in the nature of insurance), government grants for broadband, energy efficiency etc.
- The IRS has never ruled on the nature of FEMA funds and has never brought this issue up in an electric coop audit insofar as we are aware.

The Tax Cuts and Jobs Act

- Beginning in 2018, the Act instituted a 21% excise tax on the compensation and excess severance of tax exempt covered employees in excess of $1 million.
- This matches the excise tax on taxable corporation compensation.

The Tax Cuts and Jobs Act

- The Act defines a “covered employee” as any employee of a covered organization who is one of the five highest paid employees in any year after 2016. Thus, the new excise tax can apply to any individual who is currently or was previously among the five highest paid employees of the organization after 2016 (even if the individual is no longer an employee).

The Tax Cuts and Jobs Act

- For this purpose, compensation is defined as all compensation subject to federal income tax withholding is counted for purposes of the excise tax.
- It also includes any amounts that are subject to taxation under Code section 457(f) (which applies to certain deferred compensation arrangements of covered tax exempt entities).
- However, compensation does not include any Roth contributions made by the employee under the employer's 401(k) or 403(b) plan.

The Tax Cuts and Jobs Act of 2017

- The solar ITC is a 30 percent tax credit for solar systems on residential (under Section 25D) and commercial (under Section 48) properties.
- The existence of the ***solar ITC through 2021*** provides market certainty for companies to develop long-term investments that drive competition and technological innovation, which in turn, lowers costs for consumers.
- The commercial and residential ITC were maintained under the Tax Cuts and Jobs Act of 2017.

The Tax Cuts and Jobs Act of 2017

- Tax reform did not change the prior tax law expiration dates of renewable tax incentives such as the production tax credit for wind which expires in 2019.
- We will continue to work on certain renewable provisions and the nuclear production tax credit which we hope will be included in a tax extenders package to be taken up in 2018.

Tax Extenders

Bipartisan Budget Act of 2018

- On February 9, 2018, Congress passed, and the President signed into law, H.R. 1892, the "Bipartisan Budget Act of 2018" (P.L. 115-123) (the Act).
- ***<u>Many renewable tax incentives and provisions expired on December 31, 2016 but were retroactively reinstated through December 31, 2017, unless otherwise noted below:</u>***
- Section 25C, which provides a 10 percent credit for ***qualified nonbusiness energy property;***
- Section 25D credit for ***<u>residential energy property for qualified fuel cell property, small wind energy property, geothermal heat pump property, qualified solar electric property, and solar water heating property</u>***. It should be duly noted that this incentive was extended through 2021;
- Section 30B, which provides a ***<u>credit for qualified fuel cell motor vehicles;</u>***

Bipartisan Budget Act of 2018

- Section 30C, which provides ***a 30 percent credit for the cost of alternative (non-hydrogen) fuel vehicle refueling property;***
- Section 40(b)(6), which provides a ***credit for each gallon of qualified second-generation biofuel produced;***
- Section 40A credit for ***biodiesel and renewable diesel, which includes the biodiesel mixture credit, the biodiesel credit and the small agri-biodiesel producer credit;***
- Section 45L, which provides ***a credit for each qualified new energy-efficient home constructed by an eligible contractor and acquired by a person from the eligible contractor for use as a residence during the tax year;***

Bipartisan Budget Act of 2018

- Section 48 investment tax credits ***(ITC) for fiber-optic solar lighting system, small wind energy, qualified fuel cell (it should be noted these credits were extended through 2021, subject to the following phase-out requirements):***
  - If construction begins before 2020 and the asset is placed in service by the end of 2023, the ITC percentage is 30%,
  - If construction begins in 2020 and the asset is placed in service by the end of 2023, the ITC percentage is 26%,
  - If construction begins in 2021 and the asset is placed in service by the end of 2023, the ITC percentage is 22%, and
  - If construction of these facilities begins after 2021 or the project is not placed in service by the end of 2023, no ITC would be available.

Bipartisan Budget Act of 2018

- ***Qualified microturbine, combined heat and power, and geothermal heat pump facilities are entitled to a 10% ITC if construction begins before 2022;***
- Section 168(l), which provides a ***depreciation allowance equal to 50 percent of the adjusted basis of qualified second-generation biofuel plant property;***
- Section 179D ***energy tax deduction for building envelope efficiency in connection to energy efficient lighting systems, energy efficient HVAC systems; and/or an energy efficient building envelope (such as windows, doors, roofs, insulation, etc.);***

Bipartisan Budget Act of 2018

- ***The Production Tax Credit*** (PTC) under Section 45 (and ITC in lieu of PTC for facilities described in Section 45) is available, ***retroactive to January 1, 2017, for the following facilities if construction began by December 31, 2017:***
  - ***Closed-loop biomass,***
  - ***Open-loop biomass,***
  - ***Geothermal energy,***
  - ***Landfill gas,***
  - ***Trash,***
  - ***Qualified hydropower, and***
  - ***Marine and hydrokinetic renewable energy.***
- Nuclear PTC for advanced nuclear power facilities

Bipartisan Budget Act of 2018

- Additionally, the act amends Code Section 45Q which provides a credit for sequestration of carbon dioxide captured and disposed of by the taxpayer in secure geological storage or used by the taxpayer via tertiary injection in a qualified enhanced oil or natural gas recovery project.
- Qualified carbon dioxide is carbon dioxide captured from an industrial source that would otherwise be released into the atmosphere as industrial emission of greenhouse gas, and is measured at the source of capture and verified at the point of disposal or injection.
- The new Code Section 45Q increases the amount of the credit, the window for carbon capture projects, and the number of years to claim the credits.

Bipartisan Budget Act of 2018

- The 45Q tax credits could prove to be just the cure the industry needs.
- Any new fossil-fuel power plant or carbon-dioxide producing industry that commences construction before 2024 is eligible for tax credits for up to 12 years (a time cap on the credits).
- The tax credits offered are per metric ton of carbon dioxide captured: $30 if the carbon dioxide is put to use (pushing out oil from depleting fields is the most popular use) or $50 if it is simply buried in underground storage.

Tax Reform 2.0

Tax Reform 2.0

- On September 28, 2018, the House passed what is being referred to as Tax Reform 2.0.
- Technically, Tax Reform 2.0 is a collection of three bills, each with its own unique purpose. Here are the highlights of each:
  - The Protecting Family and Small Business Tax Cuts Act of 2018 would make the individual tax changes that were passed in late 2017 permanent. Currently, the lower marginal tax rates, higher Child Tax Credit, and most of the other tax changes that affect individual taxpayers are set to expire after 2025. This bill also would extend the more generous medical deduction threshold of 7.5% of AGI, which is currently set to expire after the 2018 tax year, for another two years.

Tax Reform 2.0

- The Family Savings Act of 2018 would make several changes affecting retirement, education, and general savings in the United States.
- It would remove the age limit of 70 1/2 for making traditional IRA contributions and also exempt Americans with less than $50,000 in their retirement accounts from required minimum distributions, or RMDs.
- The bill also would help families by allowing up to $7,500 in penalty-free withdrawals from retirement accounts for expenses related to a new child.
- Additionally, it would create a new type of savings account, known as a Universal Savings Account, which would have a similar tax structure to a Roth IRA but would allow $2,500 to be set aside on a tax-advantaged basis for any purpose, not just retirement.
- Finally, the bill would make some small tweaks to allowable expenses for 529 accounts and make it easier for smaller companies to join together to offer 401(k) plans.

Tax Reform 2.0

  - Finally, the American Innovation Act is the shortest bill of the three and is designed to encourage Americans to start their own businesses. It would do this by allowing qualified new businesses to deduct as much as $20,000 in start-up costs in the year they are incurred.
- While the Tax Reform 2.0 bills have passed the house, they face a challenging road ahead of them in the Senate, to say the least. In fact, the Senate isn't expected to debate this legislation at all but they may consider certain portions such as those related to retirement savings and the Family Savings Act.

IRS Ruling on Batteries and Solar

IRS Ruling on Batteries and Solar

- LTR 201809003, in which the Internal Revenue Service ("Service") ruled that the cost of installing energy storage property to be integrated into other residential solar photovoltaic system property will qualify as a "qualified solar electric property expenditure" eligible for the tax credit under Internal Revenue Code ("Code") section 25D.
- The ruling provides that the battery is considered to be property that uses solar energy to generate electricity for use in Taxpayers' dwelling unit located in the United States and used as a residence by them.
- The software management tool portion is only considered part of the qualified solar electric property so long as it is required in monitoring the charging and discharging of solar energy.

IRS Ruling on Batteries and Solar

- Additionally, labor costs that are properly allocable to the onsite preparation, assembly, or original installation of the Battery and for piping or wiring to interconnect the Battery to the home are eligible for the credit.
- The applicable percentage in the case of Taxpayers' request is 30 percent.

Appendix

Other Tax Changes

Topic	Pre-Reform Law	2017 Act
Dividends Received Deduction	70% Deduction	50% Deduction
Bonus Depreciation	50% expensing until 2019	100% expensing after 9/27/17 Phased out from 2024-2028 Available for used property G&T property excluded after 12/31/17
Meals & Entertainment	50% disallowed, no limitation on company cafeteria meal costs	Entertainment expenses no longer allowed - business meals remain 50% disallowed. Meal costs at a company cafeteria are subject to 50% disallowance until 2025 (after 2025 they are not deductible)
Like Kind Exchange Treatment	Generally Allowed	Only allowed on real estate not held for sale
R&D Expenses	Deductible	Must be capitalized and amortized over 5 years
"Local" Lobbying Expenses	Deductible	Not Deductible on or after 12/22/17
Moving Expense Reimbursements	Qualified expenses are excluded from Income of Employees	Suspended - no longer excluded until years after 2026

Meals & Entertainment

Category	Treatment
Office picnic or holiday party	100% deductible
Food for general public benefit (e.g., hot dogs provided to the public by an automobile dealership)	100% deductible
Reimbursed Expenses	100% deductible
Meals included as taxable income	100% deductible
Client business meals	50% deductible
Meals during business travel	50% deductible
Occasional overtime meals for employees	50% deductible through 2025; nondeductible after 2025
Meals for convenience of employer (e.g., catered lunches provided by a tech start-up)	50% deductible through 2025; nondeductible after 2025
De minimis fringe benefits (e.g., office snacks)	Unclear – guidance from IRS is expected
Entertainment-related meals (e.g., meal with a client during a sporting event)	Unclear – guidance from IRS is expected
Client entertainment (e.g., sporting event tickets, regardless of whether a charitable event)	Nondeductible
Club memberships	Nondeductible

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