taxnotes® state

Volume 99, Number 3 ■ January 18, 2021

The Taxability of Solar Energy Systems in New York State

by Noah Shaw, Daniel A. Spitzer, Sujata Yalamanchili, and Henry A. Zomerfeld

Reprinted from *Tax Notes State*, January 18, 2021, p. 229

The Taxability of Solar Energy Systems in New York State

by Noah Shaw, Daniel A. Spitzer, Sujata Yalamanchili, and Henry A. Zomerfeld

Noah Shaw

Daniel A. Spitzer

Sujata Yalamanchili

Henry A. Zomerfeld

Noah Shaw is a partner with the Saratoga Springs, New York, office, Daniel A. Spitzer and Sujata Yalamanchili are partners with the Buffalo office, and Henry A. Zomerfeld is a senior associate with the Buffalo office of Hodgson Russ LLP.

In this installment of Real Assessment, the authors discuss uncertainties over how New York tax jurisdictions should consider renewable energy projects when imposing property taxes.

In recent years, New York Gov. Andrew Cuomo (D) and his administration, legislative leaders, and advocates from New York state and beyond have pushed the country's most ambitious clean energy and climate laws. The 2019 Climate Leadership and Community Protection Act, for example, commits the state to achieving 70 percent renewable energy by 2030, 100 percent clean electricity by 2040, and a fully "carbon-neutral" economy by 2050. These enormous undertakings require all available tools. But the state's property tax laws continue to bedevil efforts to create an even playing field for renewable energy projects, even after a recent case involving Cornell University that many market watchers hoped would bring consistency and certainty.

The question is how tax jurisdictions should consider renewable energy projects when imposing property taxes. Unlike for oil and gas facilities, New York law does not dictate how renewable energy projects should be assessed. N.Y. Real Prop. Tax Law section 487 exempts renewable energy projects from real property taxes for 15 years, but local jurisdictions can opt out of the exemption — and often do so if only to start a negotiation with the project developer for a payment-in-lieu-of-taxes (PILOT) agreement. Further, since the state has not yet provided guidance regarding how renewable energy projects should be assessed, tax jurisdictions use different methods and arrive at wildly different conclusions, making similarly-sized projects substantially more expensive in one locality versus another. To make matters worse, some municipalities have set arbitrarily high tax assessments or instituted exorbitant PILOT requirements. Taken together, these uncertainties, inconsistencies, and uneven methods result in added expense and delay timelines for renewable energy projects across

New York, frustrating both the commercial efforts of developers and acquirers, and progress toward the state's energy and climate goals.

This uneven playing field also undercuts New York's project-siting policies, which prioritize projects on brownfields, landfills, and abandoned industrial sites; away from wetlands and prime agricultural soils; in places where the electricity system most needs reinforcement; where disadvantaged communities will benefit most; and according to other factors codified in statutes, Public Service Commission orders, and incentive program designs.

In the closely watched *Cornell University* case,[1] the Appellate Division, Fourth Department, stopped short of addressing the uncertainties that have created these problematic market conditions. The court held that solar energy systems in general are properly classified as taxable real property, but did not address how systems are to be assessed, nor arguments regarding whether the solar panel modules — which the IRS has categorized as removable personal property — should be considered real property, or if only the racking and portions affixed to the ground are properly categorized as such.[2] Nor did the Appellate Division address an issue raised by the lower court regarding whether a system decommissioning requirement precludes a determination that the installed equipment is real property. Thus, uncertainty remains, PILOT negotiations continue across the state on a tax-jurisdiction-by-tax-jurisdiction basis, and a campaign is underway to persuade the state legislature and governor to address the problem.

Background

The underlying litigation in *Cornell University* arose when Cornell challenged the Town of Seneca's assessment of a solar energy system owned by a third party, Argos Solar LLC.[3] Argos was not a party to the litigation. The ground-mounted system, as nearly all do, consisted of solar panels, wires, a racking system, two inverters, poles or pilings, a control system, and a concrete pad on which the equipment sat. The developer described the system as "plug and play," designed for disassembly and removal at the end of the contract term.[4] To remove the system, it need only be unbolted and unplugged, the racks disassembled, and the equipment carted away.[5]

Cornell offered two primary arguments why the system was not taxable as real property: Cornell is a tax-exempt educational institution, and the system constituted personal property, not taxable real property. In response, Seneca contended that although Cornell is tax exempt, the system was owned by a for-profit entity (the developer, Argos), and the relevant tax exemption requires both the landowner and system owner to be exempt. Further, the town asserted that the system met the definition of real property because it was intended to be permanently affixed to the ground.

The lower court had rejected the town's arguments and held that the system was not taxable on the basis that it should be deemed effectively owned by Cornell, and thus exempt. In so holding, the court reasoned that Cornell was the exclusive purchaser of all the electricity generated by the system, which was on Cornell's property and used solely for — and to the direct benefit of — Cornell.[6] As such, the court held that the use of the system was for Cornell's exempt educational purposes. Thus, the use of the system supported Cornell's "permissible use and beneficial ownership" of it.[7]

In dicta, the lower court also noted the inconsistency between a town requiring a solar energy system to be removed and taxing it as a

[1] *Matter of Cornell University v. Board of Assessment Review and Shana Jo Hilton, as Assessor of Town of Seneca, New York*, 186 A.D.3d 990 (4th Dep't 2020) *amended on rearg.*, 188 A.D.3d 1692 (4th Dep't 2020).

[2] Internal Revenue Bulletin: 2016-39, Sept. 26, 2016, T.D. 9784, XII(E), Example 8, 26 CFR section 1.856-10(g) ("The Treasury Department and the IRS have concluded that PV modules and inverters that are used in the generation of energy for sale to third parties do not qualify as [inherently permanent structures] under the proposed regulations.").

[3] *Cornell University v. Board of Assessment Review*, Index No. 114235-2016 (Ontario Cnty. Sup. Ct., Jan. 4, 2019).

[4] *Cornell University v. Board of Assessment Review*, Index No. 114235-2016, at *4 (Ontario Cnty. Sup. Ct., Jan. 4, 2019).

[5] *Id.*

[6] *Id.* at *5-7.

[7] *Id.* at *6.

permanent fixture.[8] Seneca, like most New York jurisdictions and permitting entities, requires that renewable energy and energy storage projects be decommissioned at the end of their useful life. This requirement is backed up by the mandatory posting of financial security.

The Appeal

Court: Solar Energy System Is Taxable Fixture

The Appellate Division's two-part decision separately addressed whether the system was taxable real property and whether Cornell's tax-exempt status affected its taxability.

Under New York law, to be subject to real property taxation, the property in question must meet one of the statutory definitions of real property under N.Y. Real Prop. Tax Law section 102(12). At issue here were two definitions: one concerning a building or structure,[9] and the other concerning a power-generating apparatus.[10] As part of the analysis of whether property is real property, courts will evaluate whether it is a fixture. Under the common law fixtures test, a fixture must be annexed to real property, be applied to the use or purpose of the realty to which it is annexed, and be intended by the parties as a permanent accession.[11] The court held that the system met all three elements of the common law fixtures test: annexation, adaptation, and intention. Without addressing the system's distinct components (that is, foundations, racking, modules, wiring, inverters, etc.), the court found that the system as a whole was a fixture because it consisted of "nearly 1,600 piles driven directly into the ground and nearly 400 piles set on footings of concrete."[12] The system and associated equipment were attached by nuts and bolts and installed on a concrete slab. Collectively, how the system was installed confirmed that it was "annexed to the real property," the court held.[13]

The court also held that the second element of the common law fixtures test was met insofar as the system applied to the use and purpose of the land, which was dedicated to generating solar energy as part of Cornell's sustainability efforts and educational mission.[14]

Finally, the court held that the third element of the test was met because the power purchase agreement between Cornell and Argos demonstrated that they desired and intended the system to be permanent for the term of the agreement.[15] This determination was made notwithstanding the system's removable nature and the requirement of the agreement and condition of the Town Planning Board that the system be removed and the property returned to its prior condition at the end of the agreement's term. The ease of removal of the system was not crucial in the court's analysis; rather, the court focused on the parties' intent.

Cornell's Tax Exemption Does Not Change Analysis

The town also contended that Cornell's tax-exempt status did not prohibit taxation of the system because it is owned by Argos. The court agreed, focusing on the agreement between Cornell and Argos that separated ownership of the land from ownership of the system. Also, Argos is responsible for removal of the system and all taxes associated with ownership of it. Cornell has the option of purchasing the system at the end of the term of the agreement. Therefore, there was not the necessary level of "dominion and control" over the system by Cornell to exempt it from taxation.[16]

Does *Cornell* Change the Status of Renewable Energy Projects?

The Appellate Division's holding in *Cornell* unfortunately does not change the status regarding real property taxation of solar or any other renewable energy or energy storage installation in New York. Thus, the industry and municipalities can expect many key questions to

[8] *Id.* at *4.

[9] N.Y. Real Prop. Tax Law section 102(12)(b).

[10] N.Y. Real Prop. Tax Law section 102(12)(f).

[11] *Matter of Metromedia Inc. v. Tax Commission of the City of New York, et al.*, 60 N.Y.2d 85 (1983).

[12] *Cornell University*, 186 A.D.3d at 990.

[13] *Id.*

[14] *See id.*

[15] *See id.*

[16] *Cornell University*, 186 A.D.3d at 990.

continue to be litigated in court and in other forums, including:

- Whether some components of a solar installation are appropriately categorized as real or personal property. (Support for the proposition that some components of a solar installation are personal property is found in IRS determinations[17] and a number of New York cases,[18] but no cases have directly addressed the issue.)
- How renewable energy facilities and the improvement they make to land should be assessed. *Cornell* did not reach this issue, and Cuomo's effort — as part of the April 1, 2020, state budget legislation — to provide guidance by confirming income capitalization as the required method for assessing solar energy systems did not survive the legislative budget process. The New York Solar Energy Industries Association and Alliance for Clean Energy New York, however, have mounted an effort to encourage legislation in the upcoming session to address key questions related to appropriate capitalization rates and identify taxable valuation streams to be used under the income capitalization method.

Conclusion

Cornell only further highlights the need for the legislature to bring certainty to the treatment and assessment of renewable energy projects. Municipality-by-municipality inconsistencies are irrational, hinder development in accordance with the Climate Leadership and Community Protection Act, undermine New York's authority under its siting laws, and undercut the state's priorities on encouraging projects to be sited at locations like brownfields and abandoned industrial sites. Legislative action addressing the method to consistently and properly value those projects will bring much-needed clarity to project developers and municipalities alike, potentially avoiding protracted litigation. ■

[17] *See supra* note 2.

[18] *See, e.g.*, *Matter of Crossman Cadillac Inc. v. Board of Assessors of the County of Nassau*, 44 N.Y.2d 963 (1978) (privately owned telephone system installed in business that was easily removed and capable of reinstallation elsewhere was not assessable as real property under N.Y. Real Prop. Tax Law section 102(12)(d)); *Charles R. Wood Enterprises Inc. v. State Tax Commission*, 67 A.D.2d 1042 (3d Dep't 1979) (various amusement rides were movable machinery and equipment, readily removable without injury to the property, and therefore not taxable real property under section 102(12)(f)); and *Metromedia Inc.*, 60 N.Y.2d at 85 (plywood sign faces attached to structures were taxable, but respondents conceded that removable signs were not).