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The New Tax Act provides potential avenue for repurposing/redeveloping closed coal-fired power plants in economically distressed communities

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As the primary source of energy generation in United States evolves from fossil fuels to renewables, left behind are hundreds of mostly coal-fired power plants, many of which are sited on or near lakes, rivers and oceans in what have become, in many metropolitan and rural areas, economically disadvantaged communities. The closing of a coal-fired power plant can create significant economic dislocation in the host community—in addition to the loss of well-paying operating and maintenance jobs, potentially millions of dollars in property taxes that are used to finance schools and municipal expenses are forfeited. At the same time, the power plant sites present, in many cases, attractive opportunities for redevelopment, either as a renewables-based facility or for residential or commercial purposes.

Part of the recently-enacted Tax Cuts and Jobs Act, Public Law 115-97 (the tax act) may provide significant financial incentives to developers and investors for the repurposing and redevelopment of closed coal-fired power plants and other vacant industrial property in economically distressed locations. However, investors and developers will need to move quickly to reach out to the governors of the states that are home to many of these plants (and there are dozens of such states) since deadlines are fast approaching for designating locations.

Qualified Opportunity Zones

The tax act adopted provisions of a bill previously known as the “Investing in Opportunity Act” which is designed to draw long-term investments to low-income communities across the nation by allowing investors to defer capital gains taxes. A principal sponsor of this legislation was Senator Tim Scott, a South Carolina republican, who worked with the Economic Innovation Group, a Washington, DC think tank identified with tech mogul Sean Parker.

The Investment in Opportunity Act requires the designation by state governors of “Qualified Opportunity Zones” (QOZs) within low-income communities. Investors can then create “Qualified Opportunity Funds” (QOFs)—private sector investment vehicles to fund development and redevelopment projects in QOZs. Investors can achieve a tax deferral, and possible exclusion, for capital gains that are reinvested into a QOF. If a taxpayer generates capital gains and invests that amount into a QOF within 180 days, the tax will be deferred until the fund investment is sold or exchanged. If the taxpayer holds the investment for five years, the taxpayer will pay tax on only 90% of the original gain. If the investment is held for seven years, only 85% of the original capital gain will be taxable. If the investment is held for ten years, the increase in the value of the fund investment is excluded from taxation. More information on the Investing in Opportunity Act can be found here.

The process for designating Qualified Opportunity Zones

Potential QOZs must be proposed by the governor of each state from among the state's low-income community (LIC) census tracts. QOZ eligibility is based on the 2011–2015 American Community Survey (ACS) five-year data from the census bureau. The Community Development Financial Institutions (CDFI) Fund has identified over 41,000 population census tracts that are eligible for designation as a QOZ, including (1) 31,680 population census tracts that contain LICs eligible for designation as QOZs and (2) 9,453 non-LIC population census tracts that are eligible for designation if a particular LIC contiguous to the non-LIC tract is designated as a QOZ. Contiguous tracts must be at or below 125% of the area's median income.

However, governors need to move quickly because proposed designations are due by March 21, 2018, although, they may request a thirty-day extension of this deadline. Nominations are to be submitted to the U.S. Treasury Secretary, who will then make the QOZ designations. Designations remain in effect for ten years and once the QOZs are set, it is unclear how they might be changed.

The Internal Revenue Service (IRS) has just released guidelines for nominating QOZs. In addition, the IRS has developed a Nomination Tool which can be accessed online by governors to make their QOZ nominations. The IRS guidance can be found here.

Pursuant to the legislative history, particular consideration should be afforded to areas that have recently experienced significant layoffs due to business closures or relocations. Thus, communities with closed coal-fired power plants within their borders are particularly well-suited for consideration.

Potential application of Qualified Opportunity Funds to repurposing/redevelopment of closed coal-fired power plants

Unlike nuclear power plants, where operators have been required by law since the 1950s to create and fund decommissioning reserves to address "end of life" decommissioning of nuclear power plants, the operators of fossil fuel power plants, unless they are a regulated utility in a state that requires decommissioning reserves, are generally not required to maintain reserves for decommissioning and demolition of closed plants. As a result, coal-fired power plants are often shuttered and "mothballed," with no long-term strategy for the decommissioning and demolition of the facility. As we discussed in a recent alert titled "Wanting to avoid zombies, states act to regulate closing power plants," although a few states have started to consider laws that mandate prompt decommissioning and demolition, there is no broad-based legislative mechanism that would assist investors and developers in shouldering the substantial costs of decontaminating, decommissioning and demolishing closed coal-fired plants. Owners of closed coal-fired power plants have struggled to attract the attention of developers and investors who would be willing to invest in the repurposing/redevelopment of the facility for other uses. The flexibility and significant tax benefits offered by QOZs provides, in our view, an unprecedented opportunity to help finance the repurposing/redevelopment of closed power plants.

This is a powerful new tool for the redevelopment of closed coal-fired power plants as well as brownfield sites and closed industrial facilities. Such sites present, in many cases, an ideal location for retrofitting a solar facility or a new manufacturing facility or, depending on the location of the site, redevelopment for commercial or residential purposes. Critical elements to the success of new business ventures such as good rail, highway and, in many cases, water access and an available workforce are already in place, making these sites attractive candidates for nomination as QOZs.

Investors, developers and property owners should reach out to their governors and highlight the advantages of nominating census tracts that contain closed power plants as QOZs in order to take advantage of this very useful provision of the tax act.

For more information on the new tax law and its application to your tax equity transactions, please contact your regular Nixon Peabody attorney or:

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