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SUBJECT Tax implications of solar panel roof
SECTION 3
SECTION 9(1)

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.
Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: 1) Are amounts received for electricity purchased by Ontario Power Authority under the Standard Offer Program in respect of a solar panel roof installed on a principal residence included in income?

2) Does the income generated from the solar panel roof affect the taxpayer's ability to claim the principal residence exemption on a possible future sale of the residence?

POSITION: 1) The amount received under the Standard Offer Program would be included in the taxpayer's income. 2) The determination is generally a question of fact, based on the conditions established in Interpretation Bulletin, IT-120R6.

REASONS: 1) The amounts received are in consideration for goods provided pursuant to the terms of a contractual arrangement between the taxpayer and the Ontario Power Authority and / or local utility company.

2) Consistent with the comments provided in IT-120R6.

2008-027535
XXXXXXXXXX Bob Naufal
(613) 957-2097
September 25, 2008

Dear XXXXXXXXXXXX :

Re: Installation of a Solar Panel Roof

We are writing in response to your letter dated April 14, 2008 to the Sudbury Tax Services Office and forwarded to our Directorate on April 17, 2008 for response.

Briefly, your letter described a situation whereby an individual taxpayer (the "Taxpayer") recently invested a significant amount of time and money for the installation of a solar panel roof on the Taxpayer's principal residence to stimulate the use of alternative sources of electric power generation that are environmentally friendly. You submit that this was an extremely costly endeavour for the Taxpayer that was not business or income motivated and that there was no intention for the Taxpayer to generate profit.

The Taxpayer was informed by the installer that once the solar panel roof was installed, it would be connected to the provincial power grid and the Taxpayer would enter into a 20-year contract with the Ontario Power Authority ("OPA") whereby the Taxpayer would receive credit (at a specified rate of \$0.42 per kilowatt) for the power generated into the grid. The credit could be used to offset the Taxpayer's hydro bill in respect of the electricity consumption on the principal residence. In a

follow-up conversation with a representative from your office (Naufal / XXXXXXXXXXXX), we were advised that this contract is described as the OPA's "Standard Offer Program".

You have asked the following questions, with respect to the above-described situation:

1) What is the tax treatment related to the credit of the \$0.42 per kilowatt of generated electricity from the solar panel roof that will be applied towards the Taxpayer's hydro consumption on the principal residence?

In this regard, it is your understanding that there is no reportable event for income tax purposes relating to the credit since there is no business purpose relating to the installation of the solar panel roof and that it is rare that the credit will exceed the Taxpayer's personal hydro consumption.

2) Does the fact that the solar panel roof is attached to the Taxpayer's principal residence affect the Taxpayer's ability to utilize the principal residence exemption on a potential sale of the residence?

In this regard, you submit that since there is no reportable transaction for income tax purposes, there would be no impact on the Taxpayer's principal residence exemption.

Our Comments

Written confirmation of the income tax implications inherent in particular transactions is given by this Directorate only where the transactions are proposed and are the subject matter of an advance income tax ruling request as described in Information Circular 70-6R5 dated May 17, 2002 issued by the Canada Revenue Agency. A fee is charged for this service. Although we are unable to provide any comments with respect to your particular fact situation otherwise than in the form of an advance income tax ruling, the following general comments may be of assistance.

Standard Offer Program

It is our understanding that the OPA and the Ontario Energy Board have developed a Renewable Energy Standard Offer Program for Ontario (the "Program"), designed to encourage and promote greater use of renewable energy sources from smaller generating projects that would be connected to an electricity distribution system in Ontario. Under the Program, an applicant enters into a contract with the OPA, pursuant to which the applicant will deliver electricity to a local electricity distribution system in Ontario for a 20-year period and receive \$0.42 cents per kilowatt hour for the delivered electricity.

To qualify under the Program, applicants must ensure that the project meets certain requirements, must be willing to make necessary investments in their facilities and must bear the costs of connection to the local distribution system and metering, as well as certain ongoing costs of operation and maintenance. Based on our understanding of the terms of the Program, the participant's sale of electricity to the grid is a separate transaction from the participant's personal consumption of electricity.

Section 3 of the Income Tax Act (the "Act") provides that a taxpayer's income from a "source" will be included in the determination of that taxpayer's income for a taxation year for purposes of Part I of the Act, including amounts received which can be characterized as income from a business (which could include an amount received in respect of an isolated transaction), property, office or employment.

It is our view that, under the terms and conditions of the Program, the Taxpayer has acquired a property that generates electrical energy for sale to the provincial power authority. Accordingly, income from such an arrangement would generally be income from a source that is a business, subject to section 3 of the Act, provided there is a reasonable expectation of profit.

Capital Cost Allowance ("CCA")

A taxpayer may deduct, in computing income from a business or property, CCA in respect of the capital cost of a depreciable property acquired for the purpose of earning income from a business or property. However, under paragraph 1102(1)(c) of the Income Tax Regulations (the "Regulations"), no deduction in respect of CCA is available with respect to a property that was not acquired for the purpose of earning income. In this regard, we are not providing any comments as to whether an individual who participates in the Program will be precluded from claiming CCA by virtue of paragraph 1102(1)(c) of the Regulations.

Where the income earning requirement is met, fixed location photovoltaic equipment that is used by the taxpayer, or by a lessee of the taxpayer, primarily for the purpose of generating electrical energy from solar energy may qualify for inclusion in subparagraph (d)(vi) of Class 43.1 of Schedule II of the Regulations, provided that it has a peak capacity of not less than 3 kilowatts of electrical output and it otherwise meets the requirements contained therein. Where such photovoltaic equipment is acquired after February 22, 2005, it may be eligible for inclusion in Class 43.2 of Schedule II of the Regulations. The Federal Budget dated March 19, 2007, proposed that eligibility for Class 43.1 and Class 43.2 be modified to eliminate the minimum size requirement for photovoltaic systems. This change will apply to eligible assets acquired on or after March 19, 2007. Generally the requirements to be met for both classes are the same, except that property included in Class 43.2 must be acquired after February 22, 2005 and before 2012 and cannot have been included in any other class by any taxpayer before it was acquired.

Property included in Class 43.2 is eligible for a CCA rate of 50 per cent, while property included in Class 43.1 is eligible for a CCA rate of 30 per cent. However, by virtue of the "available for use rules" found in subsections 13(26) to (31) of the Act, CCA for a Class 43.1 or 43.2 property that has been acquired and which is not considered available for use at the end of a taxation year may be restricted until such time as the property is available for use. A property that becomes available for use in the year is subject to a limitation of 50% of the CCA otherwise deductible in that first year as required by subsection 1100(2) of the Regulations. Where a depreciable property is used for both personal and business use, CCA can only be claimed on the portion or percentage of the capital cost that is used for business purposes.

Subsections 1100(24) to (29) of the Regulations restrict the accelerated CCA claim on Class 43.1 or 43.2 assets purchased by passive investors. This property is called "specified energy property" and where Class 43.1 or 43.2 property meets the definition of "specified energy property" in subsection 1100(25) of the Regulations, the amount of CCA that may be claimed on that property is generally limited to the income earned from such property (as per subsection 1100(24) of the Regulations). However, where Class 43.1 or 43.2 property is acquired to be used by the owner primarily for the purpose of gaining or producing income from a business carried on in Canada (other than the business of selling energy produced by the property) or from another property situated in Canada (e.g., rental property), this restriction does not apply. In other words, where the purchaser of a property that qualifies for inclusion in Class 43.1 or 43.2, uses the property in its own business, the property will not normally be affected by the rules restricting the amount of CCA that can be claimed unless the business is that of selling the energy produced by the acquired property. In the situation you have described above, it appears that CCA would be restricted by the specified energy property rules as your client is an individual that is in the business of selling energy (electricity) produced by the property in question to the OPA under the Program.

Principal Residence

Generally, if a taxpayer has partially converted a principal residence to an income-producing use, paragraph 45(1)(c) of the Act provides for a deemed disposition of the portion of the property so converted (such portion is usually calculated on the basis of the area involved) for proceeds equal to its proportionate share of the property's FMV. Paragraph 45(1)(c) also provides for a deemed reacquisition immediately thereafter of the same portion of the property at a cost equal to the very same amount. Any gain otherwise determined on the deemed disposition is usually eliminated or reduced by the principal residence exemption.

It is generally our practice not to apply the deemed disposition rule, but rather to consider that the entire property retains its nature as a principal residence, where all of the following conditions are met:

- a) the income-producing use is ancillary to the main use of the property as a residence,
- b) there is no structural change to the property, and
- c) no CCA is claimed on the property.

These conditions can be met, for example, where a taxpayer carries on a business of caring for children in his or her home, rents one or more rooms in the home, or has an office or other work space in the home which is used in connection with his or her business or employment. In addition, examples of what could be considered a structural change include, the conversion of the front half of a house into a store, the conversion of a portion of a house into a self-contained domestic establishment for earning rental income (a duplex, triplex, etc.), and alterations to a house to accommodate separate business premises. The determination of whether these conditions are met in respect of a particular property is generally a question of fact that can only be made on a case by case basis.

We trust that our comments will be of assistance to you.

for Director
Reorganizations and Resources Division
Income Tax Rulings Directorate
Legislative Policy and Regulatory Affairs Branch