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Prepaid Power Contracts

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Some renewable projects, especially solar projects, use prepaid power contracts. Under a prepaid power contract, the offtaker enters into a long term contract with the supplier to buy electricity. Upon the closing, the offtaker prepays the supplier for a portion of the electricity to be delivered under the contract.

Before the Tax Cut and Jobs Act ("TCJA"), if the prepayment is properly structured, the supplier of the electricity may be able to defer the inclusion of the upfront payment for income tax purposes. Instead of reporting the full prepayment as its taxable income upon the receipt of such prepayment, the supplier was allowed, before the enactment of the TCJA, to take the prepayment into income only as and when the performance for such prepayment occurs, i.e. when electricity is delivered to the offtaker in the future under the contract. That resulted in a deferral benefit to the supplier because the supplier received cash payments upfront, but reported taxable income much later, typically over the course of the prepaid power contract.

The TCJA disallows such deferral benefits from prepayments for "goods and services" identified by the IRS. The TJCA requires a prepayment for such "goods and services" to be reported immediately as income, or at best, partly in the year the prepayment is received and the balance in the year immediately thereafter. Even though the IRS has not issued guidance to identify such "goods and services", since electricity has been treated by the IRS as "inventoriable goods", it is expected that prepaid power contracts for the delivery of electricity will be affected by the TCJA.

Before the enactment of the TCJA, the tax benefits of prepaid power contracts enabled developers to reduce the cost of capital for renewable energy projects. The changes imposed by TCJA likely would affect the pricing on prepaid power contracts, and incentivize developers to find alternative sources of capital.