

CONGRESS ACTS TO EXTEND RENEWABLE ENERGY CREDITS

On October 3, 2008, the U.S. House of Representatives passed the so-called "bailout" bill, which includes extensions and modifications of the section 45 production tax credit. The Senate previously passed the bill, and the President is expected to sign it into law. The bill (H.R. 1424) makes the following amendments to section 45:

- Extends the placement-in-service deadline for wind and refined coal facilities by 1 year, to December 31, 2009;
- Extends the placement-in-service deadline for other energy sources under section 45 (open-loop biomass, closed-loop biomass, geothermal, landfill gas, trash, and qualified hydropower) for 2 years, to December 31, 2010;
- Expands the definition of "trash facilities" to include those that gasify trash in addition to those that burn trash to produce electricity;
- Allows the section 45 production tax credit for new units of open- and closed-loop biomass facilities;
- Clarifies the rules governing credit eligibility for adding hydroelectric equipment to an existing nonhydroelectric dam;
- Allows the credit for marine energy facilities (replacing "small irrigation" facilities under current law); and
- Modifies the requirements for coal to qualify as "refined coal."

H.R. 1424 also makes changes in other tax provisions of interest to the renewable energy industry. This Update summarizes the provisions of the bill of most interest to developers of and investors in renewable energy projects.

Production Tax Credit Extension

The extension of the section 45 tax credit was the most important change made in the bill for the renewable energy industry. The current December 31, 2008 deadline to place projects in service was disrupting planning and development activity for new projects. The 2-year extension for most projects (1-year for wind and refined coal projects) will provide needed certainty in the short- to mid-term. Eventually, a long-term extension is needed to avoid the periodic disruptions that occur every time we approach a deadline.

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Trash Gasification

The bill expands the section 45 tax credit to include electricity produced using gas from a trash gasification facility. Under current law, the credit is allowed only for "combustion" or "burning" of trash, and the bill expands this to allow the credit for any "use" of trash, including gasification. The credit will be allowed for electricity produced using gas from a trash gasification facility after the date that H.R. 1424 becomes law, as long as the trash gasification facility was placed in service after October 22, 2004.

Expanded Biomass Facilities

The bill allows the owner of an open- or closed-loop biomass facility to add a new unit to an existing facility and claim additional credits to the extent of increased electricity production attributable to the new unit. New units eligible for credits under section 45 are those placed in service after the date that H.R. 1424 becomes law. This rule on expanding biomass facilities is similar to a rule Congress previously adopted for expanded trash facilities in 2005.

Nonhydroelectric Dam Conversion

The bill clarifies the rules to determine whether a nonhydroelectric dam that has been converted to a hydroelectric facility will be eligible for the renewable electricity production credit under section 45. Under the new rules, which go into effect on the date that H.R. 1424 becomes law, a hydroelectric project that is licensed by the Federal Energy Regulatory Commission and is installed on a dam that did not previously produce hydroelectric power is eligible to claim section 45 tax credits. Among other requirements, following the installation of the hydroelectric project, the dam and project must be operated so that the water level is not changed from what it would have been if the hydroelectric project had not been installed.

Marine Renewables

H.R. 1424 adds "marine and hydrokinetic renewable energy" as a new class of "qualified energy resource" to replace the more narrow class of "small irrigation power" under current law. Marine and hydrokinetic renewable energy sources include (i) waves, tides, and currents in oceans, estuaries, and tidal areas, (ii) free flowing water in rivers, lakes, and streams, (iii) free flowing water in an irrigation system, canal, or other man-made channel, including projects that utilize non-mechanical structures to accelerate the flow of water for electric power production purposes, and (iv) ocean thermal energy conversion.

To be eligible for the section 45 production tax credit, facilities that use marine and hydrokinetic renewable energy must have a nameplate capacity of at least 150 kilowatts. The facility must be placed in service after the date that H.R. 1424 becomes law (an existing small irrigation facility will remain eligible for the credit for the remainder of its unexpired 5- or 10-year tax credit period), and the current placement-in-service deadline for these facilities is December 31, 2011 (one year longer than for most other facility types under the bill). Marine and hydrokinetic facilities are entitled to one-half the basic credit rate, or 1.0¢/kWh in 2008 (the same as open-loop biomass, geothermal, landfill gas, trash, and qualified hydropower facilities).

Refined Coal Modifications

The bill makes two changes to the definition of "refined coal." First, for new refined coal (to include steel industry fuel as described below) facilities placed in service after December 31, 2008, the bill (i) eliminates the requirement that the value of refined coal be at least 50% more than the value of the feedstock coal and (ii) increases from 20% to 40% the required reduction in

emissions of either sulfur dioxide or mercury released when burning refined coal as compared to the emissions released when burning the feedstock coal or comparable coal (the required reduction in emissions of nitrogen oxide remains at 20%).

Second, H.R. 1424 adds "steel industry fuel" as a separate class of refined coal for fuel produced and sold after September 30, 2008. Steel industry fuel is fuel that (i) is produced by distributing coal waste sludge (tar decanter sludge and related byproducts of the coking process) on coal and (ii) is used as a feedstock for the manufacture of coke. The credit amount for steel industry fuel is \$2 per barrel-of-oil equivalent (an amount of fuel with an energy content of 5.8 million Btus) and, unlike other refined coal, the credit rate for steel industry fuel is not subject to phase-out based on the general market price of feedstock coal.

Facilities that were eligible for the section 45K nonconventional fuel credit have not been eligible to claim the section 45 credit for the production of refined coal. H.R. 1424 removes this restriction on facilities to the extent that they produce steel industry fuel. Such facilities, however, may not claim both the section 45K credit and the section 45 credit with respect to production of the same fuel.

The credit period for steel industry fuel facilities ends on December 31, 2009 for facilities placed in service any time before January 1, 2009, and ends one year after the date a facility is placed in service for facilities placed in service after December 31, 2008. The placement-in-service requirements and credit period rules apply both to new facilities and to existing facilities that are modified to produce steel industry fuel.

As noted above, under the bill the placement-in-service deadline for all refined coal facilities, including steel industry fuel facilities, ends on December 31, 2009.

Other Renewable Energy Provisions

- *Extension of 30% Investment Tax Credit.* H.R. 1424 extends for 8 years, through December 31, 2016, the placement-in-service deadline for solar, fuel cell, and microturbine property eligible for the 30% investment tax credit. In addition, the maximum credit for fuel cell property is increased from \$500 per 0.5 kilowatt to \$1,500 per 0.5 kilowatt.
- *Investment Tax Credit Allowed Against the Alternative Minimum Tax.* For tax years beginning after the date that H.R. 1424 becomes law, a taxpayer will be allowed to use the investment tax credit for energy property to reduce the taxpayer's AMT liability.
- *10% Investment Tax Credit for Combined Heat and Power System Property.* H.R. 1424 provides a 10% investment tax credit for combined heat and power system property placed in service before January 1, 2017. The credit is phased out for projects with capacities in excess of 15 megawatts or 20,000 horsepower (or a combination of the two), and the credit is eliminated for projects with capacities in excess of 50 megawatts or 67,000 horsepower.
- *30% Investment Tax Credit for Small Wind Projects.* H.R. 1424 provides a 30% investment tax credit for wind turbines with a nameplate capacity of not more than 100 kilowatts that are placed in service before January 1, 2017. The maximum credit that a taxpayer may claim for all small wind projects placed in service in one year is \$4,000.
- *10% Investment Tax Credit for Geothermal Heat Pump Systems.* H.R. 1424 provides a 10% investment tax credit for equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal

heat sink to cool a structure and that is placed in service before January 1, 2017.

- *New Clean Renewable Energy Bonds.* H.R. 1424 authorizes a new series of CREBs in an aggregate amount of up to \$800 million. The credit rate for these new CREBs will be 70% of the credit rate for previous CREBs.

Work Left Undone

H.R. 1424 provides a necessary short-term boost for the renewable energy industry. The 2-year extension of the section 45 credit placement-in-service window will allow development to continue on new projects. Unless Congress enacts a long-term (or permanent) extension of the placement-in-service window, the industry will face the same uncertainties beginning in 2010 as have disrupted the industry this year (and in prior years).

One provision favored by the House that is not in the final bill is a cap on the total amount of the section 45 credit that can be claimed over the life of a facility. The House had proposed to cap the total credit for any facility at 35% of the taxpayer's capital investment, determined on a present value basis. This provision may be revived in new energy tax legislation next year.

Other areas of particular concern for some of our clients include tax credit rate parity (allowing the same tax credit rate for all facility types under section 45), clarifying or removing the draconian "anti-double dip" rule that disqualifies an LFG facility from eligibility for the section 45 credit if it takes any gas from an old section 29/45K landfill, and expanding the types of facilities and energy resources eligible for the section 45 credit to reflect and support the full range of innovation occurring.

This Update provides only a brief summary of some of the provisions of H.R. 1424 that are of interest to the renewable energy industry. In addition to the provisions addressed in this Update, H.R. 1424 includes the financial system bailout, a one-year patch to continue AMT relief for taxpayers through 2008, extensions of many non-energy-related tax provisions that expired at the end of 2007 or will expire at the end of 2008, and numerous energy-related tax and non-tax provisions not included in this Update. The Joint Committee on Taxation has estimated that, in addition to the \$700 billion cost for the financial system bailout, H.R. 1424 will reduce tax revenues more than \$100 billion over ten years.

In short, H.R. 1424 is a massive piece of legislation that defies any short summary. We will be happy to review with you any of the provisions of H.R. 1424 that are of interest to you or your business.

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