

RATH YOUNG PIGNATELLI

RENEWABLE ENERGY UPDATE

February 2009

RENEWABLE ENERGY PROVISIONS IN STIMULUS ACT

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009. This Act, also known as the Stimulus Bill, contains several important energy tax provisions, including:

- Extending the placement-in-service deadline for certain energy sources under section 45 (open-loop biomass, closed-loop biomass, geothermal, landfill gas, trash, qualified hydropower and marine and hydrokinetic) to December 31, 2013;
- Extending the placement-in-service deadline for wind under section 45 to December 31, 2012;
- Allowing owners of new renewable energy facilities to claim an upfront 30% investment tax credit under Section 48 instead of claiming the production tax credit under section 45 over 10 years;
- Allowing owners of new renewable energy facilities to elect a tax-free cash grant instead of claiming the investment tax credit;
- Repealing the phase-out of the investment tax credit for tax-exempt bond and subsidized energy financing; and
- Extending 50% "bonus depreciation" for projects placed in service in 2009.

Non-tax provisions include a loan guarantee program for renewable energy projects that is estimated to allow the Department of Energy to guarantee up to \$60 billion in new loans.

This Update summarizes the provisions of the Act of most interest to developers of, and investors in, renewable energy projects.

Production Tax Credit Extension

The Act extends the placement-in-service deadline for renewable energy projects to qualify for the section 45 electricity production tax credit through 2013 for most facility types (2012 for wind). This extension will prevent disruption of new projects and increase planning certainty. A longer-term extension is still desirable to avoid the periodic disruptions that occur every time we approach a deadline. This extension of the section 45 placement-in-service deadline also applies to projects that instead claim the section 48 investment tax credit discussed next.

The Rath, Young and Pignatelli Energy and Tax Practice Groups represent clients seeking to develop, operate, and invest in energy projects that qualify for federal tax benefits. For more information on the matters discussed in this Renewable Energy Update or other aspects of our practice, please contact:

- Curt Whittaker
(mcw@rathlaw.com)
- Chuck Willing
(cgw@rathlaw.com)
- Bill Ardinger
(wfa@rathlaw.com)
- Paul Burkett
(pab@rathlaw.com)

You may call us at (603) 226-2600 or visit us on the web at www.rathlaw.com.

National Impact. Uniquely New Hampshire.

Rath, Young and Pignatelli, P.C.
www.rathlaw.com

One Capital Plaza
Concord, NH 03302-1500
T (603) 226-2600
F (603) 226-2700

20 Trafalgar Square
Nashua, NH 03063
T (603) 889-9952
F (603) 595-7489

54 Canal Street
Boston, MA 02114
T (617) 523-8080
F (617) 523-8855

RENEWABLE ENERGY UPDATE

February 2009

Investment Tax Credit Election

The Act amends section 48 to allow qualifying facilities placed in service before the end of 2013 (2012 for wind) to claim the investment tax credit ("ITC") up front instead of taking the section 45 production tax credit ("PTC") over 10 years. This option is generally available for all section 45 renewable energy facility types. The ITC is equal to 30% of the costs attributable to the section 45 "facility," which is not well-defined for most facility types (other than wind and open-loop biomass), and these eligible costs will be less than the total project costs.

The basis of a project that claims the ITC is reduced by 50% of the ITC amount. This reduction in basis applies to both bonus depreciation (discussed below) and regular depreciation.

Under special rules applicable to the ITC, a facility may be sold to and leased back from an investor within 3 months after the facility is placed in service, and the investor will be allowed to claim the ITC. The ITC may also be claimed by a lessee (which must recognize additional income in the amount of 50% of the credit over the same period that the lessor depreciates the property).

The ITC has limitations that must be considered before claiming the ITC over the PTC. As noted above, the property eligible for the credit is limited to the "facility" so the credit amount will not be 30% of all project costs. The "facility" includes all components necessary to produce electricity but does not generally include fuel handling or storage equipment, electrical transformers or transmission equipment or ancillary site improvements.

In addition, the credit is subject to "recapture" if the project is sold less than 5 years after it is placed in service. This recapture rule is applied at the owner level for a project owned in a partnership or limited liability company. The recapture amount is 20% of the credit (treated as an additional tax) for each year less than 5 that the project (or interest) is owned.

A project that elects to claim the ITC instead of the PTC is barred from later claiming the PTC, and the election is irrevocable.

This election (and the option described below to claim a tax-free cash grant instead of either the ITC or the PTC) presents both opportunities and risks for project developers and investors. The 30% up-front ITC may be more valuable than the 10-year PTC on a present value basis, and the ITC eliminates production risks, at least after 5 years. In addition, as discussed below, the ITC is not reduced if the project uses tax-exempt bonds or subsidized loans for financing. The ability to use lease and sale-leaseback structures with the ITC may also create additional opportunities for developers and investors.

On the other hand, the ITC recapture rules present real risks and uncertainty during the 5-year recapture period. Specifically, project developers and investors must consider the risk of recapture following a sale in foreclosure, as well as the risk that a change in interests in a partnership or limited liability company may occur.

This new election requires immediate guidance from the Internal Revenue Service or the Treasury Department on a number of questions, such as:

RENEWABLE ENERGY UPDATE

February 2009

- Whether changing the mix of fuel used at a facility will result in recapture;
- Whether capital improvements or additions to a facility that claimed the ITC are eligible for the ITC or whether the ITC for section 45 facilities is available only for the original facility; and
- Whether certain facilities that are not eligible for the PTC (such as landfill gas facilities that use gas from an old section 29/45K landfill) are nevertheless eligible for the ITC.

Grants in Lieu of Credits

Under the Act, taxpayers that place in service new energy property eligible for the ITC (including renewable energy facilities that might also be eligible for the PTC) have the option to take a tax-free cash grant from the U.S. Treasury instead of claiming the ITC (or the PTC). The grant amount is generally the same as the amount of the ITC that could be claimed (30% in the case of a renewable energy facility described in section 45(d), a solar facility and certain other energy property, or 10% for other ITC property such as co-generation facilities). The taxpayer will include 50% of the grant amount in the depreciable basis of the property. (and will be able to deduct this amount as bonus depreciation, if available, or as regular depreciation).

To claim a grant, a taxpayer must place the property in service during 2009 or 2010, or must begin construction of the property in 2009 or 2010 and place it in service before the end of 2012 for wind facilities, before the end of 2013 for other section 45 facilities and before the end of 2016 for any other ITC property. If a

taxpayer accepts a grant, it cannot claim either the ITC or the PTC with respect to the same property.

To receive a grant, a taxpayer must make an application with the Treasury before October 1, 2011. The grant will be paid no later than 60 days after the later of the date of the grant application or the date that the grant property is placed in service.

In the Act, Congress has directed the Treasury to adopt recapture rules for the grant program similar to the recapture rules applicable to the ITC. In addition, guidance will be required on some other questions, such as:

- Whether the ITC sale-leaseback and lease rules apply to the grant program;
- Whether capital improvements or additions to a facility that claimed the ITC or the PTC in a prior year are eligible for the grant; and
- Whether the Treasury will pre-qualify projects for a grant before the start of construction.

ITC Phase-Out Repealed

Previously, section 48(a)(4) proportionately reduced the amount of the ITC to the extent of any tax-exempt bond or subsidized energy loan financing used to build or acquire energy property. The Act repeals this phase-out for property placed in service after December 31, 2008. As a result, new renewable energy projects that use tax-exempt bonds or government loans and that would, as a result, only be able to claim a portion (not less than 50%) of the amount of the PTC otherwise available may be able to realize more value by electing the ITC.

Bonus Depreciation

The Act extends 50% bonus depreciation for an additional year through 2009. Property eligible for bonus depreciation must have a depreciable life of 20 years or less, which will include all or almost all renewable energy property. The property must be placed in service in 2009 and must not be acquired pursuant to a contract entered into before 2008. For certain property with a longer construction period, bonus depreciation will be available after 2009 if the property is acquired pursuant to a binding written contract entered into in 2008 or 2009.

Bonus depreciation is valuable for developers and investors. Under this program, the owner of a renewable energy facility can claim the ITC (or take a grant), deduct 50% of its remaining investment in the facility and get regular first-year depreciation for the balance of its investment, all in the year the project is placed in service. For example, if a taxpayer places in service in 2009 renewable energy property with a cost of \$1 million that is eligible for the ITC and bonus depreciation and has a regular depreciation life of 5 years, then the taxpayer can claim in 2009 (1) an ITC of \$300,000, (2) bonus depreciation of \$425,000 and (3) regular depreciation of \$85,000, leaving \$340,000 to be depreciated over the next 4 1/2 years.

As an alternative to claiming bonus depreciation, corporate taxpayers with suspended alternative minimum tax credits or research credits may elect to accelerate the use of those credits into 2009 rather than claiming bonus depreciation in 2009.

Loan Guarantees

The Act authorizes the Department of Energy to provide loan guarantees for new energy projects that begin construction no later than September 30, 2011, including projects that use renewable energy to produce electrical or thermal energy. The Act appropriates \$6 billion dollars for this new loan guarantee program, and Congress has estimated that this appropriation will support up to \$60 billion in new loans.

Other Tax Provisions

- *Section 179 Expensing.* The Act extends through 2009 the increased expensing deductions available under 179. This provision allows taxpayers to deduct up to \$250,000 of costs of new property placed in service in 2009. The deduction is reduced if the total amount of property placed in service in 2009 exceeds \$800,000, and is eliminated altogether if the amount of property placed in service in 2009 exceeds \$1,050,000.
- *Net Operating Loss Carryback for Small Businesses.* The Act allows a small business (gross receipts less than \$15 million) to elect to increase the carryback of net operating losses arising in 2008 from 2 years to 5 years.
- *Investment Tax Credit for Advanced Energy Property.* The Act authorizes the Treasury to allocate up to \$2 billion in new tax credits by the middle of 2011 under a program that allows a 30% investment credit for depreciable property used in projects that re-equip, expand or establish manufacturing facilities that produce materials for solar, wind or

RENEWABLE ENERGY UPDATE

February 2009

geothermal energy, or for electricity grids designed for transmission of electricity from renewable sources. Taxpayers must apply to receive an allocation of credits under this program, and the Treasury, in consultation with the Department of Energy, will award the credits to qualifying projects.

- *New Clean Renewable Energy Bonds ("New CREBs")*. The Act authorizes the issuance of \$1.6 billion in New CREBs for the funding of renewable energy facilities that qualify for the Section 45 credit and are owned by a public power provider, a government body, or a cooperative electric company.

On the Horizon

Extending the section 45 placement-in-service window will facilitate continued development of new projects. Allowing renewable energy projects to qualify for the investment tax credit or to elect to receive a tax-free cash grant should also boost investment in new facilities, and these provisions also help reduce some of the economic disparities in the treatment of different technologies

under section 45. However, without a long-term (or permanent) extension of the placement-in-service window for these programs, the industry will continue to be plagued with uncertainty and disruption in the coming years.

Congress is likely to take up a full-blown energy policy bill that could address gaps in existing legislation. Just last week, the Senate Energy Committee held a hearing on a draft Renewable Electricity Standard bill designed to increase U.S. production of electricity from renewable sources.

Other items that might be addressed include tax credit rate parity under section 45 (allowing the same tax credit rate for all facility types), clarifying or removing the draconian "anti-double dip" rule that disqualifies a landfill gas 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 production tax credit and the section 48 investment tax credit to reflect and support the full range of innovation occurring in the industry.

This Update provides only a brief summary of some of the provisions of The Act that concern the renewable energy industry. As was the case with last October's "Bailout" bill, the Act is too large (over 1,000 pages and with a price tag of nearly \$800 billion) to summarize in a few short pages. We are happy to review with you any of the provisions of the Act that are of interest to you or your business.

CIRCULAR 230 NOTICE: This Update is not intended to be used, and it may not be used by any person, for the purpose of (1) avoiding penalties under the United States Internal Revenue Code, or (2) promoting, marketing, or recommending to any other party any transaction or matter addressed herein.