



ATTORNEY
 ALERT

Renewable Energy Federal Tax Benefits

The Emergency Economic Stabilization Act of 2008

Tax benefits available for renewable energy projects are an important incentive for developers, financial investors and sponsors of such projects. On October 3, 2008, these benefits were extended by the Emergency Economic Stabilization Act of 2008 (the “Act”). The following summarizes:

Section A Federal Tax Benefits by Project Type under § 45(a) and § 48(a),¹ as extended by the Act.

Section B Qualifications, Durations, and Expirations.

Section C Structuring to Maximize Tax Benefits.

Section A

In this alert we will cover three significant federal tax benefits: (1) the production tax credit (“PTC”), (2) the investment tax credit (“ITC”), and (3) accelerated depreciation. The charts contained in this alert illustrate the tax benefits associated with each type of energy project and the impact of the Act on each such project.

Project	PTC*	Placed in Service Date Under Old Law	Placed in Service Date as Extended by the Act	Depreciation
Biomass (Closed-Loop)	2.1 cents per kW/Hr	1/1/09	1/1/11	5 Years MACRS
Biomass (Open-Loop)	1.0 cents per kW/Hr	1/1/09	1/1/11	5 Years MACRS
Geothermal and Solar**	2.1 cents per kW/Hr	1/1/09	1/1/11	5 Years MACRS (but for electricity, only up to the electrical transmission stage)
Municipal Solid Waste / Land Fill Gas & Trash Combustion	1.0 cents per kW/Hr	1/1/09	1/1/11	7 Years MACRS
Qualified Hydropower	1.0 cents per kW/Hr	1/1/09	1/1/11	20 Years MACRS
Wind	2.1 cents per kW/Hr	1/1/09	1/1/10	5 Years MACRS

* Subject to annual adjustment based on a reference to the GDP Implicit Price Deflator. These figures are based on IRS Notice 2008-48.

** Geothermal and solar projects cannot utilize both the ITC and PTC.

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SECTION B

Production Tax Credit

To be eligible for the PTC, the facility must be “placed in service” before expiration of the credit. If this deadline is met then the PTC is available to the “owner” of the facility over a period of years beginning in the year when the project is “placed in service” (the “Duration”). Currently, the Duration for PTCs is generally 10 years. However, because the Duration was formerly 5 years, there is a question of whether upgrades, modifications or additions to a facility would cause the facility to have a new “placed in service” date. In determining whether a new “placed in service” date was created, the general rule is that the value of the used property cannot be more than 20% of the new facility’s fair market value (commonly known as the “80/20 test”).

Generally, “placed in service” occurs when the property is placed in a condition or state of readiness and availability for a specifically designed function. However, decades of case law and Internal Revenue Service (“IRS”) guidance has interpreted the meaning of “placed in service” in various contexts, so the facts of the transaction need to be considered when determining whether all or a portion of the facility meets this requirement by the prescribed deadline.

The Act extended the “placed in service” date for wind facilities by 1 year and the “placed in service” date for the remaining types of projects by 2 years. Additionally, the Act made the credit available to marine and hydrokinetic energy projects.²

It is important to note that the PTC is available with respect to energy “produced by the taxpayer” and, therefore, the taxpayer must own the facility.³ For these purposes partners in partnerships are treated as owners and producers.

Project	ITC*	Expiration Under Old Law	Expiration as Extended by the Act	Depreciation
Geothermal**	10%	12/31/08	12/31/16	(See PTC chart on previous page)
Qualified Fuel Cell	30%	12/31/08	12/31/16	5 Years MACRS
Qualified Microturbine	10% (not to exceed \$200 for each kW of capacity)	12/31/08	12/31/16	5 Years MACRS
Solar**	30%	12/31/08	12/31/16	5 Years MACRS

* The ITC is calculated by multiplying the applicable percentage by the basis of the renewable energy property placed in service.

** Geothermal and solar projects cannot utilize both the ITC and PTC.

Investment Tax Credit

The ITC is derived from taking a percentage of the basis of the energy property placed in service during the taxable year. Because the ITC is a component of the general business credit, it may generally be carried back 1 year and forward 20 years.⁴ The amount of the ITC is either 30% or 10%. The taxpayer must either construct, reconstruct, erect or be the first user of the

energy property.⁵ The term “energy property” includes the type of property listed in the chart above. The ITC is limited in part if the energy property is financed by governmentally subsidized energy financing or tax-exempt private activity bonds. Further, the ITC for qualified fuel cell property may not exceed \$1,500 for each 0.5 kW of the property’s capacity and the ITC for qualified microturbine property may not exceed \$200 for each kW of capacity.

The ITC was set to expire on December 31, 2008; however, the Act extended the ITC until December 31, 2016. In addition, the Act modified the definition of “energy property” to include (1) combined heat and fuel property, (2) small wind energy property, and (3) geothermal heat pump systems. Finally, the Act allows the ITC to offset the alternative minimum tax.⁶

SECTION C

In order to finance projects, developers and others (for example private equity sponsors) need to maximize the tax benefits.

Tax benefits for a project have a limited duration (typically spanning over 5 to 10 years). In order to maximize the value of the tax benefits it is essential to match the tax benefits with taxable income. Typically, developers are in less demand for the tax benefits in the early years of the project, while some investors can gain an upside from their investment if they can fully utilize the tax benefits. As a result, structures typically are arranged to allocate tax items (including credits) disproportionately to the investors for an initial period of years. After this period of initial allocation, there is a “flip” so that the developer thereafter is allocated 90-95% of the tax items. These are often referred to as “flip partnership structures.”

Flip partnership structures raise a number of tax issues that investors and developers must understand and negotiate at the outset of the business relationship. For example, allocation of depreciation deductions take on an added

significance and complexity where the developer contributes appreciated equipment. Also, there are pitfalls which must be avoided when devising an exit strategy. A carelessly structured partnership may either not take full advantage of tax opportunities or, alternatively, may be so aggressive that the IRS will not respect the allocations. Either consequence is unacceptable as tax savings is a critical component to the transaction.

The IRS has issued guidelines on these types of allocations in Revenue Procedure 2007-65. Although this revenue procedure (a) is not law, and (b) specifically only addresses wind projects, as a practical matter financial investors are demanding that their transactions be structured to comply with the guidelines set forth in Revenue Procedure 2007-65.⁷

CONCLUSION

Federal tax benefits have been critical to closing the financial gap faced by renewable project developers and providing a vibrant source of equity in the renewable sector notwithstanding the start/stop nature of Congressional enactments. The Act provides the long-awaited for extensions of the PTC and the ITC tax benefits. Moreover, the ITC extension is lengthy enough to allow project developers to be more confident that their projects will be complete prior to expiration.

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- 1 References to “§” and “Code” are to the Internal Revenue Code of 1986, as amended.
- 2 Marine and hydrokinetic energy generally includes energy produced from the natural movements of water (waves, tides, currents, free flowing water, or differentials in ocean temperature) but does not include any energy derived from any source which utilizes a dam, diversionary structure, or impoundment for electric power purposes. This category includes small irrigation power facilities, a separate category prior to the Act.
- 3 However, there are exceptions to this general rule. For example, for open-loop biomass facilities (as well as certain modified closed-loop biomass facilities), if the owner is not also the producer, then the person eligible for the credit is the lessee or operator of the facility.
- 4 §§ 38(b)(1) and 39
- 5 Generally, “energy property” for these purposes does not include property if it is used predominantly in the taxpayer’s trade or business of selling electricity, water, sewage, local gas or telephone services, except that this exception does not apply to qualified fuel cell or microturbine property used for furnishing or selling telephone or domestic telegraph services.
- 6 § 38(c)(4)(B) (as amended by the Act and generally effective for tax years beginning after October 3, 2008).
- 7 See, March 18, 2008 letter from the Department of Treasury (Eric Solomon) to industry participants.

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