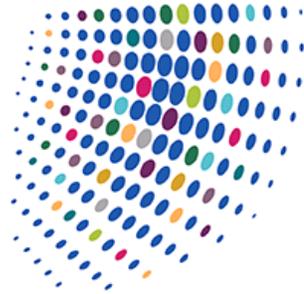


Alerts & Publications



Recently Enacted Stimulus Bill Expands Renewable Energy Tax Credits and Introduces Renewable Energy Grants

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On February 17th, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (“Recovery Act”), the widely discussed \$787.2 billion economic stimulus package. The Recovery Act provides approximately \$70 billion in funding and tax benefits for energy-related investments.

Of particular interest, the Recovery Act has made important changes to the primary tax credits for renewable energy production, the Section 45 production tax credit (“PTC”) and Section 48 investment tax credit (“ITC”), and has created a new program that allows project owners to receive grants from the federal government in lieu of claiming the PTC or ITC (“Renewable Energy Grants”).

This client alert summarizes the key features of the revised PTC and ITC, and provides an overview of the new Renewable Energy Grant program.

Production Tax Credit

The PTC is a tax credit generally based on the number of kilowatt-hours (“kWh”) of energy produced by a taxpayer and sold to an unrelated person from facilities owned by the taxpayer that use various renewable resources, and is generally available for the first ten years of an eligible facility’s operation. On a prospective basis, eligible facilities include wind, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash combustion, refined coal, qualified hydropower and marine and hydrokinetic facilities placed in service before certain prescribed dates. The Recovery Act extended the applicable “placed-in-service” dates for most types of eligible facilities such that the PTC is now available for refined coal facilities placed in service before January 1, 2010, wind facilities placed in service before January 1, 2013 and all other eligible facilities to be placed in service before January 1, 2014. The PTC credit amount is adjusted for inflation annually. For calendar year 2008, the PTC provided a 2.1¢ per kilowatt-hour (kWh) credit for wind, geothermal and closed-loop biomass, and generally a 1¢ per kWh credit for other eligible technologies. Any unused PTC amount generally may be carried back one year and carried forward twenty years. The PTC cannot be claimed with respect to facilities for which the ITC has been claimed.

Investment Tax Credit

The ITC is a credit for the costs of construction or acquisition of certain property used in the production of energy from renewable resources. The ITC cannot be claimed for property which is part of a facility with respect to which the PTC has ever been claimed. The amount of the credit is generally equal to either 30% or 10% of such costs, depending on the type of property (although certain specified dollar limits apply to fuel cell, microturbine and heat and power system property). The 30% ITC generally applies to certain solar energy equipment, fuel cell equipment and wind turbines with nameplate capacity of less than 100 kilowatts ("small wind property"), and the 10% ITC generally applies to certain geothermal, qualified microturbine, combined heat and power system and geothermal heat pump property. Any unused ITC amount generally may be carried back one year and carried forward twenty years. The ITC may be subject to recapture upon certain dispositions of the property with respect to which it has been claimed.

Importantly, the Recovery Act added a temporary provision under which an irrevocable election may be made to claim the 30% ITC instead of the PTC for certain property used in facilities that would generally be eligible for the PTC, including most tangible property used in wind, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash combustion, qualified hydropower and marine and hydrokinetic facilities.

The Recovery Act also repealed the rule that previously reduced the amount of ITC-eligible costs by the amount of such costs financed with tax-exempt debt or funding provided under certain government programs, and removed the \$4,000 cap on the credit amount that previously applied to small wind facilities.

Renewable Energy Grants

Under the Renewable Energy Grant program, taxpayers now have the option of applying to receive a Renewable Energy Grant from the U.S. Treasury Department ("Treasury") in lieu of the PTC or ITC with respect to certain property. Renewable Energy Grants are available in the amount of 30% of the cost of depreciable wind, closed-loop biomass, open-loop biomass, specified geothermal, landfill gas, trash combustion, qualified hydropower, marine and hydrokinetic, fuel cell, solar and small wind property. Renewable Energy Grants are also available in the amount of 10% of the cost of other specified geothermal, qualified microturbine, combined heat and power system, and geothermal heat pump property. Certain specified dollar limits apply to fuel cell, microturbine and heat and power system property. Renewable Energy Grants are available only if the property was placed in service in 2009 or 2010, or construction begins during 2009 or 2010 and property is placed in service by a specified date (before January 1, 2013, 2014 or 2017, depending on the type of property). Certain tax-exempt entities (including federal state and local governments and 501(c) (3) organizations) and certain energy-related cooperatives are ineligible for Renewable Energy Grants, as are partnerships and other pass-through entities of which any such ineligible person is a partner or equity owner.

Applications for Renewable Energy Grants must be received by Treasury before October 1, 2011. Renewable Energy Grant proceeds are not disbursed until after the property is placed in service (or after submission of the grant application, if later). Renewable Energy Grants are not includable in taxable income, but 50% of the amount of such grants is excluded from the basis of the property (reducing depreciation deductions over the life of the property). Renewable Energy Grants may be subject to recapture upon certain dispositions or changes in use of property with respect to which such they have been claimed.

General guidelines for choosing between PTC, ITC and Renewable Energy Grant

As a result of the changes instituted by the Recovery Act, many projects will be eligible for any of the PTC, the ITC and a Renewable Energy Grant (one notable exception is new solar energy projects, which do not qualify for the PTC). However, only one of these benefits may be claimed with respect to a particular project, and taxpayers will have to determine which of these options offers the greatest tax benefit. This generally depends on factors such as the ability to use tax credits, the type of renewable energy technology to be employed and the projected construction costs of and output from a particular project.

More specifically, taxpayers should consider the following points in making this choice:

- Renewable Energy Grants may offer a significant benefit to developers who are unable to use the PTC or ITC (generally as a result of having insufficient taxable income) because, instead of having to enter into complex arrangements with investors who are able to use the PTC or ITC in order to realize the benefit of such credits, eligible developers may receive grant proceeds directly from Treasury. Developers who choose Renewable Energy Grants may also be able to retain all of the equity in an energy project if they are able to secure sufficient debt financing.
- The disadvantages of Renewable Energy Grants relative to the PTC and ITC are:
 - the potential taxability of grant proceeds at the state level;
 - the potential inability to benefit from depreciation deductions (investment structures commonly employed to facilitate the use of the PTC and ITC, such as sale-leasebacks and “flip” arrangements, generally also facilitate the use of depreciation deductions from the underlying project);
 - the necessity of submitting an application to Treasury (as opposed to simply claiming the ITC or PTC on a tax return);
 - the lack of established rules and regulations concerning the qualification for and administration of the grants;
 - the potential applicability of the “Buy American” provisions of the Recovery Act and certain federal reporting, accountability and other rules (which may raise construction and legal compliance costs); and
 - the relatively short time window during which the grants are available (which may be problematic if there is uncertainty as to whether construction will be commenced and completed within the applicable time limits, since substituting the ITC for a Renewable Energy Grant may involve significant reorganization of the project structure and financing since it generally will require the prearranged participation of outside investors through complex investment structures).
- The ITC and Renewable Energy Grants offer a potentially significant timing advantage relative to the PTC because the benefits of the ITC or a Renewable Energy Grant may be realized as soon as the project is placed in service (although these benefits must be recaptured in whole or in part if the project is sold before the end of the applicable “recapture” period, which is five

years from the date the property is placed in service for the ITC and has not yet been determined for Renewable Energy Grants). In contrast, the benefits of the PTC are realized gradually over a relatively long period of time (generally ten years).

- The ITC and Renewable Energy Grants are not dependent on the actual production of energy by the project with respect to which they are claimed. Thus, by claiming the ITC or applying for a Renewable Energy Grant instead of claiming the PTC, taxpayers avoid the risk that a project's actual energy production or sales will be substantially lower than projected.
- The benefit of the ITC generally may be more easily transferred from a developer unable to use tax credits to investors that are able to use tax credits than the PTC, because the PTC rules require that the taxpayer not only own the facility, but also produce and sell the energy (thus, sale-leaseback and similar structures potentially may be available for projects using the ITC where they generally were not available for projects using PTCs).
- The PTC is designed to phase out automatically if market rates for electricity produced from the relevant renewable source rise above certain prescribed levels, which compounds the timing disadvantage and production risk described above.
- Subject to the risks mentioned above, the PTC may be preferable to a Renewable Energy Grant or the ITC where, based on projected energy production and sales, the present value of the PTC generated by the facility will be materially higher than the present value of the available Renewable Energy Grant or ITC. This is more likely to be the case where the project is of a type that will only qualify for the 10% ITC or a 10% Renewable Energy Grant.
- Periodic shutdowns of a project can be problematic regardless of whether a developer has chosen the PTC, ITC or a Renewable Energy Grant because such shutdowns may result in a change in a project's placed-in-service date to a later date, which can cause the project to become ineligible for any of these benefits and can result in a significant increase in tax (and possibly penalties and interest) because it would change the timing of depreciation deductions with respect to the project. To the extent that a later placed-in-service date does not result in ineligibility:
 - with respect to the PTC, periodic shutdowns will reduce the credit in an amount commensurate with the length and frequency of the shutdowns (since the PTC is based on a project's level of output);
 - with respect to the ITC and Renewable Energy Grants, a later placed-in-service date may:
 - result in the movement of the ITC to a later tax year, which could result in a significant increase in tax (and possibly penalties and interest); and
 - delay the receipt of Renewable Energy Grant funds.