



Alert

Tax Advice and Controversy Client Service Group

To: Our Clients and Friends

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Energy Tax Alert The American Recovery and Reinvestment Act is Signed into Law

The American Recovery and Reinvestment Act (the "Recovery Act"), signed by President Obama on February 17, 2009, contains numerous tax-related incentives for investment in renewable energy sources. The following is a brief summary of notable changes.

Extension of Credit for Electricity Produced from Renewable Resources

Effective as of the date of enactment of the Recovery Act, the placement in service deadline for wind facilities was extended from December 31, 2009 to December 31, 2012; the deadline for closed- and open-loop biomass, geothermal, solar, trash and hydropower facilities was extended from December 31, 2010 to December 31, 2013; and the deadline for marine and hydrokinetic facilities was extended from December 31, 2010 to December 31, 2011.

Production tax credits are available to taxpayers who own qualified facilities for renewable electricity produced and sold to an unrelated person equal to 1.5 cents per kilowatt hour, indexed for inflation (in 2008, the credit allowable was 2.1 cents per kilowatt hour). Qualified facilities are defined in Section 45(d) of the Internal Revenue Code of 1986, as amended (the "Code") and include certain wind, closed- and open-loop biomass, geothermal, solar, landfill gas, trash, refined coal, hydropower, marine and hydrokinetic facilities. The credit is allowable to the taxpayer over a 10-year period beginning with the placement in service of the qualified facility.

A technical amendment contained in the Recovery Act clarifies that the definition of marine and hydrokinetic facilities includes small irrigation power facilities previously provided for in Code Section 45(d)(5).

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Elimination of Basis Adjustment for Properties Receiving Subsidized Energy Financing or Private Activity Bonds

After December 31, 2008, properties eligible for the investment credit will no longer be subject to basis adjustments if they receive subsidized energy financing or private activity bonds.

Section 48 provides for a 30 percent investment credit for qualified fuel cell, solar energy and small wind energy property, and a 10 percent investment credit for qualified microturbine property or combined heat and power system property and equipment used to produce, distribute or use geothermal energy. However, prior to the Recovery Act, the basis of energy property receiving any subsidized energy financing or private activity bonds was reduced by a fraction, the numerator of which is the portion of the basis of the property attributable to the subsidized energy financing or private activity bonds received by the project and the denominator of which is the aggregate basis of the property. The Recovery Act partially eliminates this basis reduction by amending Section 48(a)(4) of the Code to provide that the taxpayer's basis in the project attributable to costs incurred after December 31, 2008 is not subject to reduction by any subsidized energy financing or private activity bonds. The taxpayer's basis in the project attributable to costs incurred prior to December 31, 2008, however, remains subject to reduction as provided in Section 48(a)(4)(A).

Elimination of Cap on Credit for Qualified Small Wind Energy Property

The Recovery Act also eliminated the \$4000 limitation on credit for qualified small wind energy property, which was previously contained in Section 48(c) of the Code.

Election of the Investment Credit in Lieu of the Production Credit

For facilities placed in service after December 31, 2008, the Recovery Act allows a taxpayer who is eligible for the Section 45 Energy Production Credit to make an irrevocable election to treat qualified property that is part of a qualified facility as energy property. This allows the taxpayer to receive a 30 percent investment credit upon placement in service rather than the production credit of 1.5 cents (indexed for inflation) over a period of ten years after placement in service. To make this election the taxpayer may not claim, and prior to the election, may not have claimed, any credit allowable under Section 45 with respect to the qualified investment credit facility.

For purpose of this election, 'qualified investment credit facilities' are wind facilities (as defined in Section 45) placed in service prior to 2012, and closed- and open-loop biomass, geothermal, solar, landfill gas, trash, hydropower and marine and hydrokinetic renewable energy facilities placed in service prior to 2013. 'Qualified property' is depreciable tangible personal or other property that is an integral part of the qualified facility (excluding the building and its structural components).

Election to Receive Grant in Lieu of Credit

Section 1603 of the Recovery Act creates a program whereby taxpayers may apply for a grant for reimbursement of a portion of the expense of specified energy property placed in service during 2009 or 2010, or property placed in service after 2010 but prior to the end of the credit termination date (as provided in Section 45(d) or 48 of the Code).

The amount of the grant will be equal to the depreciable basis of the specified energy property times an applicable percentage of 30 percent for qualified facilities, qualified fuel cell property, solar property and qualified small wind energy property or 10 percent for geothermal property, qualified microturbine property, combined heat and power systems and geothermal heat pump property. The deadline for applications to be submitted to the Secretary of the Treasury for the grants is October 1, 2011. If the property is sold or otherwise disposed of, or ceases to be specified energy property, Section 1603(e) of the Recovery Act provides that the Secretary of the Treasury shall provide for a recapture of the "appropriate percentage of the grant amount in such manner as the Secretary of the Treasury determines appropriate."

The Recovery Act also adds a new Section 48(d) to the Code which provides that no credit shall be allowed under Sections 45 or 48 for any property with respect to which a grant is paid (in the taxable year in which such grant is made or for any subsequent year). Grants are not treated as gross income to the taxpayer, but are taken in to account in the determination of the basis of the relevant property, reducing the taxpayer's basis by 50 percent of the amount of the grant awarded.

Expansion of New Clean Renewable Energy Bonds

For obligations issued after the date of its enactment, the Recovery Act increased the bond limitation for New Clean Renewable Energy Bonds from \$800,000,000 to \$1,600,000,000.

Section 54C of the Code provides for a program of subsidized financing for certain qualified projects, administered by the Secretary of the Treasury. Qualified projects are defined as any facility defined in Code Section 45(d), excluding Indian coal production and refined coal production facilities. New Clean Renewable Energy Bonds provide interest-free loans to qualified borrowers (defined as mutual or cooperative electric companies, governmental bodies and public power providers), and, in lieu of interest payments, the holders of the bonds receive an annual credit against their federal income tax liability at a rate determined and published by the Secretary of the Treasury.

The Secretary has not yet solicited applications for the allocations of the volume cap under Code Section 54C.

Expansion of Qualified Energy Conservation Bonds

For obligations issued after the date of its enactment, the Recovery Act increased the bond limitation for Qualified Energy Conservation Bonds from \$800,000,000 to \$3,200,000,000.

Section 54D of the Code provides for qualified energy conservation bonds which provide financing for qualified conservation purposes.

Qualified conservation purposes are defined in Section 54D(f)(1) as capital expenditures for (i) the reduction of energy consumption in publicly owned buildings by at least 20 percent; (ii) the implementation of green community programs, (iii) rural development involving the production of electricity from renewable energy resources, and (iv) any qualified facility as defined in Section 45(d), excluding refined coal production and Indian coal production facilities.

Like Clean Renewable Energy Bonds and New Clean Renewable Energy Bonds, Qualified Energy Conservation Bonds provide interest-free loans, and in lieu of interest payments, the holders of the bonds receive an annual credit against their federal income tax liability (in the case of Qualified Energy Conservation Bonds, 70 percent of the amount of credit determined for Clean Renewable Energy Bonds).

The Recovery Act also clarified that the meaning of “green community programs,” included providing loans, grants or other repayment mechanisms to implement such programs, and that any bonds issued for such purposes would not constitute private activity bonds within the meaning of Section 54D(e)(3).

New Qualified Advanced Energy Manufacturing Project Credit

The Recovery Act establishes a new manufacturing project tax credit intended to encourage the development of a domestic manufacturing base supporting the production and conservation of renewable energy. Specifically, the Recovery Act establishes, as part of Code Section 46, a new 30 percent credit for investment in qualified property used in a qualified advanced energy manufacturing project.

A qualified advanced energy manufacturing project is a project that re-equips, expands, or establishes a manufacturing facility for the production of the following:

1. Property designed to be used to produce energy from the sun, wind, or geothermal deposits or other renewable resources;
2. Fuel cells, microturbines, or an energy storage system for use with electric or hybrid-electric motor vehicles;
3. Electric grids to support the transmission of intermittent sources of renewable energy, including storage of that energy;
4. Property designed to capture and sequester carbon dioxide emissions;
5. Property designed to refine or blend renewable fuels or to produce energy conservation technologies (including energy-conserving lighting technologies and smart grid technologies);
6. New qualified plug-in electric drive motor vehicles, qualified plug-in electric vehicles; or components which are designed specifically for use with these vehicles, including electric motors, generators, and power control units; or
7. Other advanced energy property designed to reduce green house gas emissions.

Qualified property must be (i) necessary for the production of a qualified advanced energy manufacturing project, (ii) tangible personal property or other tangible property (not including a building or its structural components) but only if such property is used as an integral part of the qualified investment credit facility and (iii) depreciable (or allowed to be amortized in lieu of depreciation). The Recovery Act specifically disallows property designed to manufacture equipment for

use in the refining or blending of any transportation fuel (other than renewable fuels) from the definition of qualified property. Additionally, basis of qualified property must be reduced by the amount of credit received.

Credits are available only for qualified advanced energy manufacturing projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. The Secretary of Treasury must establish a certification program no later than 180 days after the enactment date, and may allocate up to \$2.3 billion in credits. In selecting projects to certify, the Recovery Act requires that the Secretary consider only those projects where there is a reasonable expectation of commercial viability along with whether the project will provide the following:

1. The greatest domestic job creation (both direct and indirect) during the credit period,
2. The greatest net impact in avoiding or reducing air pollutants or anthropogenic emissions of greenhouse gases,
3. The greatest potential for technological innovation and commercial deployment,
4. The lowest levelized cost of generated or stored energy or of measured reduction in energy consumption of or greenhouse gas emission (based on costs of the full supply chain), and
5. The shortest project time from certification to completion.

Each project application must be submitted during the two-year period beginning on the date such certification program is established. An applicant for certification has one year from the date the Secretary accepts the application to provide the Secretary with evidence that the requirements for certification have been met. Upon certification, the applicant has three years from the date of issuance of the certification to place the project in service.

The provisions establishing this new tax credit are effective after the date of the enactment of the Recovery Act for basis attributable to costs incurred after the date of enactment. Basis attributable to costs incurred prior to the date of enactment is not eligible for the credit.

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