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2009 Stimulus Act Expands Tax Benefits for Alternative Energy Projects

On February 17, 2009, President Obama signed into law H.R. 1, the American Recovery and Reinvestment Act of 2009 (the "2009 Act"). In line with President Obama's vision of advancing alternative energy technologies, the tax-related provisions of the 2009 Act include several programs intended to stimulate alternative energy projects through targeted income tax relief.

Background – The 2008 Act

In many regards, the energy-related provisions in the 2009 Act build off similar provisions discussed in our two prior advisories regarding the Energy Improvement and Extension Act (the "2008 Act"), signed by President Bush on October 3, 2008. As discussed in more detail in those advisories, the 2008 Act included many extensions of existing energy-related tax credits, as well as the creation of several new credits and incentives for renewable energy, emission reduction, and the use of alternative fuels. Key provisions of the 2008 Act included:

- The extension of the renewable energy production tax credit for wind and refined coal production facilities through 2009, and for most other qualifying renewable source facilities through 2010 (along with an amplification of the credit to include new expansions of existing biomass facilities and activities generating electricity from renewable marine sources).
- The extension through 2016 of the 30% investment tax credit for solar energy property and qualified fuel cell property and of the 10% investment tax credit for qualified microturbine property (together with the addition of small commercial wind as a category of qualified investment for the 30% credit and the creation of a new 10% investment tax credit for combined heat and power systems and geothermal heat pumps). The 2008 Act also for the first time made certain of these credits available as an offset to a taxpayer's alternative minimum tax liability.
- The extension of the clean renewable energy bond ("CREB") credit through 2009 and the creation of a new category of qualified tax credit bonds ("QECBs") to provide financing for state and local government initiatives designed to reduce greenhouse gas emissions.
- The provision of \$1.5 billion in new tax credits for the creation of advanced coal electricity projects and certain coal gasification projects that demonstrate high degrees of carbon

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dioxide ("CO₂") separation and sequestration percentages.

- The addition of two new credits for carbon capture and sequestration: \$10 per metric ton of qualified CO₂ captured and transported from an industrial source for use in enhanced oil recovery, and \$20 per metric ton for qualified CO₂ captured and transported from an industrial source for permanent underground storage.
- The expansion of the provision allowing taxpayers to write off 50% of the cost of facilities that produce cellulosic biofuel ethanol to include the production of other cellulosic biofuels.
- An increase in the per gallon production tax credit for the production of certain biodiesel, and the extension through 2009 of both this credit and the credit for small biodiesel producers.
- The extension through 2010 of the 30% credit for non-hydrogen related qualified alternative fueling property, such as natural gas or E85.
- The extension through 2013 of the provision allowing taxpayers to deduct the cost of certain energy-efficient property installed in commercial buildings.
- A reduction of the depreciable life of smart electric meters and smart electric grids from 20 years to 10 years, and the prescription of the 150% declining balance method to calculate depreciation deductions for such property.

Please see our previous advisories, "Bailout Legislation Includes Important Energy-Related Tax Provisions" (October 14, 2008) and "The Energy Improvement and Extension Act of 2008" (October 24, 2008), for a more complete discussion of the energy-related tax provisions of the 2008 Act.

New Law – The 2009 Act

The 2009 Act extends and modifies a number of existing energy incentives (including in part those affected by the 2008 Act) and adds several new energy-related incentives. Following is a summary of the more important of these provisions.

Production and Investment Tax Credits

The 2009 Act extends the availability of the existing production tax credit ("PTC") for the production of electricity from renewable energy sources by two to three years, depending upon the technology used. For wind facilities, the required in-service date in

order to be eligible for the credit has been extended for three years until December 31, 2012. For closed-loop biomass facilities, open-loop biomass facilities, geothermal facilities, landfill gas facilities, trash facilities, and qualified hydropower facilities, a similar three-year extension until December 31, 2013 was put into place. The in-service date for PTCs for marine and hydrokinetic renewable energy facilities was extended for two years until December 31, 2013. Reflecting the Obama administration's shift in policy away from fossil fuels, the 2009 Act does not extend the in-service cutoff dates for non-renewable source facilities, such as refined coal production facilities (December 31, 2009) and Indian coal production facilities (December 31, 2008). Qualifying facilities may generally claim the PTCs over ten years.

The 2009 Act also adds a new provision allowing taxpayers to elect to claim, in lieu of these PTCs, a 30 percent investment tax credit on qualified property¹ included within certain eligible facilities. Prior to the 2009 Act, property for which a PTC was allowed was not eligible for the investment tax credit. This new provision allows taxpayers to make an irrevocable election to claim an investment tax credit on qualified property included as a part of an eligible facility. Property for which an election is made will not be eligible for the PTC. Facilities eligible for this election include (i) wind facilities placed in service in the years 2009-2012, and (ii) closed-loop biomass facilities, open-loop biomass facilities, geothermal facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities placed in service in the years 2009-2013.

In an effort to provide increased flexibility and a source of funds to bridge a potential credit gap, the 2009 Act also provides a third alternative subsidy for qualifying projects in place of either of the production or investment tax credits. Under this alternative, the Treasury Department is authorized to provide construction grants in lieu of these otherwise available credits for certain eligible energy property. In order for a taxpayer to be entitled to a grant under this provision, eligible property must either (a) be placed in service in 2009 or 2010 or (b) begin construction during 2009 or 2010 and be placed in service not later than the applicable "credit termination date" for the property.² Energy property eligible for a grant under this provision generally includes qualified property (see above discussion of the investment tax credit election) which is a part of a facility described above under the PTC extension provisions or certain fuel cell, solar, small wind energy, geothermal, microturbine, combined heat and power systems, or geothermal heat pump property.

The grant amount is equal to 30 percent of the cost basis for eligible PTC facilities and for fuel cell, solar and small wind energy property, and 10 percent for all other eligible property, with dollar limitations on fuel cell, microturbine or combined heat and power system property. Grant applications must be received before October 1, 2011, and payment of the grant is generally made during the 60-day period beginning on the later of the date of application or the date the property was placed in service. The amount of the grant is not includible in the taxpayer's gross income, but the basis of the corresponding energy property must be reduced by 50% of the grant amount. Some or all of a grant may be subject to recapture if the grant property is disposed of within a five-year recapture period.

Generally, the investment tax credit for energy property is allowed for a certain percentage (either 10% or 30%, depending on the type of property) of the basis of eligible property placed in service during the tax year. Before the 2009 Act, the amount eligible for the credit was reduced in proportion to the share of the basis of the property that was financed either by "subsidized energy financing" (i.e., financing provided under a Federal, state or local program a principal purpose of which was to provide subsidized financing for projects designed to conserve or produce energy) or by proceeds of private activity bonds. The 2009 Act repeals this provision, effectively increasing the investment tax credit for taxpayers who use either of such financing sources to fund energy production or conservation projects.

The 2009 Act also repeals a \$4,000 limitation on the annual credit for "qualified small wind energy property." In addition, it repeals credit caps on qualified solar water heating property (\$2,000) and qualified geothermal heat pump property (\$2,000).

Clean Renewable Energy Bond and Qualified Tax Credit Bond Provisions

The 2009 Act increases the new CREB limitation from \$800 million to \$2.4 billion, an increase of \$1.6 billion. A CREB is generally any bond designated as a new clean renewable energy bond issued as part of an issue by a qualified issuer (i.e., a public power provider, cooperative electric company, governmental body, clean renewable energy bond lender, or not-for-profit electric utility which has received a loan or loan guarantee under the Rural Electrification Act) if 100 percent of the available project proceeds are to be used for capital expenditures incurred by governmental bodies, public power providers, or cooperative electric companies for one or more qualified renewable energy facilities (as defined for purposes of the renewable energy sources PTC). Holders of such bonds on certain specified credit allowance dates

generally may claim a tax credit equal to the product of the face amount of the bond and the bond's applicable credit rate.

The 2009 Act also authorizes the issuance of an additional \$2.4 billion of QEGBs, increasing the national limitation on such bonds from \$800 billion to \$3.2 billion. QEGBs are certain designated bonds issued by a state or local government the proceeds of which are to be used for one or more qualifying energy conservation purposes generally aimed at reducing greenhouse gas emissions (e.g., capital expenditures for rural development involving the production of electricity from renewable sources, mass commuting facilities, and demonstration projects to promote the commercialization of green building technology). Holders of such bonds on certain specified credit allowance dates generally may claim a tax credit equal to the product of the face amount of the bond and the bond's applicable credit rate.

Refueling Property Credit Expansion

The 2009 Act increases the alternative fuel vehicle refueling property credit, generally available for qualified alternative fuel vehicle refueling property (i.e., property (not including a building or its structural components) for the storage or dispensing of certain clean-burning fuels or electricity). For property that is not hydrogen-related, the credit percentage is increased from 30 percent to 50 percent, and the credit limitation is increased from \$30,000 to \$50,000 for depreciable trade or business property and from \$1,000 to \$2,000 for other property (such as residential). For hydrogen-related property, the credit limitation is increased from \$30,000 to \$200,000 for depreciable trade or business property (and no change is made to the credit percentage or to the credit limitation for non-depreciable hydrogen-related property). These changes are temporary; they apply only to property placed in service during 2009 or 2010.

Credit for Investment in Advanced Energy Facilities

The 2009 Act creates a new credit designed to encourage the development of a domestic manufacturing base necessary to produce the property for which various credits and other tax-related incentives have been created under the 2008 and 2009 Acts. This credit is equal to 30 percent of the cost basis of qualified property (see above discussion of the investment tax credit election) placed in service as a part of the construction or expansion of a manufacturing facility which produces certain property related to these incentives.³ To be eligible for the credit, a project must first be certified by the Secretary of the Treasury through a competitive bidding process.

Not later than 180 days after the date of enactment of this section, the Treasury and Energy Departments must establish a qualifying advanced energy project program to consider and award certifications for qualified investments eligible for credits to qualifying project sponsors. The total amount of credits allocated under the program is limited to \$2.3 billion, and the credit applies only to the portion of the qualified project that was constructed, reconstructed, or erected after February 17, 2009. In order to avoid a double benefit, this credit is not available with respect to a qualified investment for which an energy, advanced coal project, or qualifying gasification project credit is allowed.

Requirements for Carbon Dioxide Sequestration

The 2009 Act adds a new requirement to the carbon dioxide sequestration provisions adopted in 2008. Under these provisions, taxpayers are entitled to a credit of (a) \$20 per metric ton of qualified carbon dioxide that is captured at a qualified facility and disposed of by the taxpayer in secure geological storage (i.e., a geologic structure that does not allow carbon dioxide to escape into the atmosphere) and (b) \$10 per metric ton of qualified carbon dioxide that is captured at a qualified facility and used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project. The 2009 Act now requires that carbon dioxide used as a tertiary injectant also be disposed of in secure geological storage in order to get the carbon dioxide sequestration credit. In addition, the definition of permanent geological storage has been expanded to include oil and gas reservoirs in addition to unminable coal seams and deep saline formations. The 2009 Act also clarifies that the \$20 credit amount is not available with respect to carbon dioxide that is used as a tertiary injectant.

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If you have questions about the potential impact of the 2009 Act on your business, please contact a Sullivan & Worcester lawyer listed above.

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ENDNOTES

¹ "Qualified property" means depreciable (or amortizable) tangible personal property and other depreciable (or amortizable) tangible property (not including a building or its structural components), but only if such other tangible property is used as an integral part of the qualified investment credit facility.

² For qualifying property eligible for PTCs, the applicable credit termination date is generally the required in-service date under the PTC rules. For other qualifying property, the applicable credit termination date is December 31, 2016.

³ The credit is available for qualified property constituting part of a "qualifying advanced energy project," which is defined as a project which re-equips, expands, or establishes a manufacturing facility for the production of (i) property designed to be used to produce energy from the sun, wind, geothermal deposits, or other renewable resources, (ii) fuel cells, microturbines, or an energy storage system for use with electric or hybrid-electric motor vehicles, (iii) electric grids to support the transmission of intermittent sources of renewable energy, including storage of such energy, (iv) property designed to capture and sequester carbon dioxide emissions, (v) property designed to refine or blend renewable fuels or to produce energy conservation technologies (including energy-conserving lighting technologies and smart grid technologies), (vi) new qualified plug-in electric drive motor vehicles, qualified plug-in electric vehicles, or components which are designed specifically for use with such vehicles, including electric motors, generators, and power control units, or (vii) other advanced energy property designed to reduce greenhouse gas emissions (excluding, in all instances, any portion of a project for the production of any property used in refining or blending any non-renewable transportation fuel).