

ENERGY UPDATE

Energy Tax Provisions in the American Recovery and Reinvestment Act of 2009

February 19, 2009

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the “Act”). This new economic stimulus package contains more than \$787 billion in government spending and tax cuts, including more than \$20 billion in tax incentives for the renewable energy industry. It extends and expands several energy tax provisions for both businesses and individuals and provides some general tax incentives relevant to businesses in the energy industry. In addition, it creates a new grant program and manufacturing tax credit.

The full text of the tax provisions of the Act can be accessed at this link: http://thomas.loc.gov/home/h1/Recovery_Bill_Div_B.pdf

The full text of the appropriation provisions of the Act can be accessed at this link: http://thomas.loc.gov/home/h1/Recovery_Bill_Div_A.pdf

Business Tax Provisions

PTC Extension. The Act extends the placed-in-service deadline for various facilities that are eligible for the production tax credit (PTC) under section 45. (All

references to “section” are to the Internal Revenue Code of 1986, as amended.) For wind facilities, the deadline is extended through December 31, 2012 (a three-year extension), and for closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash, and qualified hydropower facilities, the deadline is extended through December 31, 2013 (a three-year extension). For marine and hydrokinetic renewable energy facilities, the deadline is extended through December 31, 2013 (a two-year extension).

ITC Election. The Act permits an irrevocable election to treat “qualified property” that is part of a “qualified investment credit facility” as “energy property” so as to qualify for the investment tax credit (ITC) under section 48 in an amount equal to 30 percent of the taxpayer’s basis in such property. The term “qualified investment credit facility” means a renewable energy facility described in certain provisions of section 45, but only if no PTCs have been allowed under section 45 with respect to such facility and the taxpayer makes an irrevocable election to have the ITC provision apply. The term “qualified property” means property (i) that is 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 (ii) with respect to which depreciation (or amortization) is allowable. The election is available with respect to wind facilities that are placed in service in 2009, 2010, 2011 or 2012, and closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash, qualified hydropower, and marine and hydrokinetic renewable energy facilities that are placed in service in 2009, 2010, 2011, 2012 or 2013. If the taxpayer elects to have the ITC provision apply to a facility, no PTCs are allowed with respect to the facility subject to the election. Because the facility is treated as energy property eligible for the ITC, the rules applicable to other ITC property (e.g., recapture rules, basis adjustment rules, sale-leaseback rules) apply.

Subsidized Energy Financing Limitation on ITC. For periods after December 31, 2008, the Act repeals the provision that limits the amount of the section 48 ITC for energy property that is financed by subsidized energy financing or the proceeds of private activity bonds. It is noteworthy that the Act does not change the subsidized energy financing rules applicable to PTCs.

Grant Program. The Act creates a new program that provides for a grant to a “person” (as distinguished from a “taxpayer”) who places in service specified energy property. The grant is intended to reimburse such a person for a portion of the cost of the energy facility and is in lieu of section 45 PTCs or section 48 ITCs, as applicable. The Secretary of the Treasury (as opposed to the Secretary of Energy) will administer the

program, and a person must apply in order to receive a grant. The Secretary shall pay the grant within 60 days of the later of the application date or the date the property is placed in service. The grant application must be received before October 1, 2011. To qualify for a grant, the property must be either (i) placed in service during 2009 or 2010 or (ii) placed in service after 2010 and before the expiration of the PTC or ITC applicable to such facility, but only if construction of such property began during 2009 or 2010. The grant amount is 30 percent of the basis of certain qualified energy producing facilities, including facilities using wind, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash, qualified hydropower, and marine and hydrokinetic renewable energy, as well as qualified fuel cell, solar, and qualified small wind energy property. The grant amount is 10 percent of the basis of certain qualified microturbine, combined heat and power, and geothermal heatpump property. For qualified fuel cell, qualified microturbine, and combined heat and power property, the grant is subject to the same dollar limitations applicable to the section 48 ITC for such property. Certain governmental entities, tax-exempt entities, cooperatives, not-for-profit utilities and Indian tribes are not be eligible to receive a grant. The grant is not includible in the gross income of the recipient, but the grant is taken into account in determining the basis of the property to which the grant relates (i.e., the basis is reduced by 50 percent of the grant amount). In addition, any ITCs previously claimed on progress expenditures with respect to property subject to a grant must be recaptured by the taxpayer. The Secretary

of the Treasury is directed to apply rules similar to those under section 50 in making a grant. Thus, a grant is subject to recapture over a five-year period if the applicable facility is disposed of or if it ceases to be a qualified renewable energy facility. Given the language mandating that the Secretary “shall” pay the grants, coupled with the appropriations to the Secretary of the amounts necessary to carry out the provision, it does not appear that the Secretary has any discretion in providing a grant beyond the procedural application requirements.

Carbon Sequestration. The Act modifies the section 45Q credit for carbon sequestration, which is \$10 per metric ton of qualified carbon dioxide that is captured by the taxpayer at a qualified facility and used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, to require that carbon dioxide be disposed of by the taxpayer in secure geological storage. The Secretary of the Treasury, in consultation with the Administrator of the Environmental Protection Agency, the Secretary of Energy and the Secretary of the Interior, shall establish regulations for determining adequate security measures.

Depreciation. The Act provides for a one-year extension of the acquisition and placed-in-service dates applicable to the 50 percent additional depreciation deduction (the so-called “bonus depreciation”) allowed pursuant to section 168(k) for certain qualified property. In addition, the Act extends for taxable years beginning in 2009 the \$250,000 limit on the amount of depreciable property that can be expensed

under section 179 and the \$800,000 phase-out threshold.

Net Operating Loss Carryback. The Act allows certain small businesses to elect to extend the carryback period under section 172(b) for a net operating loss (NOL) from any taxable year ending in 2008 (or, if elected by the taxpayer, the NOL from any taxable year beginning in 2008) from two years to any of three, four or five years. The election applies only to a corporation or partnership (or a sole proprietorship) with average annual gross receipts for the three prior taxable years of not more than \$15 million.

Advanced Energy Manufacturing Credit. The Act provides a new 30-percent credit for investment in “qualified property” used in a “qualified advanced energy manufacturing project.” The term “qualified advanced energy manufacturing project” means a project that re-equips, expands or establishes a manufacturing facility for the production of: property designed to be used to produce energy from the sun, wind, geothermal deposits or other renewable resources; fuel cells, microturbines or an energy storage system for use with electric or hybrid-electric motor vehicles; electric grids to support the transmission of intermittent sources of renewable energy, including storage of such energy; property designed to capture and sequester carbon dioxide emissions; property designed to refine or blend renewable fuels or to produce energy conservation technologies (including energy-conserving lighting technologies and smart grid technologies); new qualified plug-in electric drive motor vehicles, qualified plug-in electric vehicles or components that

are designed specifically for use with such vehicles; and certain other advanced energy property to reduce greenhouse gas emissions. There are a number of requirements to constitute qualified property. The credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy, in an aggregate amount up to \$2.3 billion. The Secretary must establish the certification program within 180 days of enactment. The criteria for selecting projects include the commercial viability, domestic job creation, environmental impact, innovation potential, the levelized cost of generated or stored energy or of measured reduction in energy consumption or greenhouse gas emission, and time to completion.

Other. Additional notable changes for businesses in the Act include:

- The removal of the \$4,000 limitation on the section 48 ITC for qualified small wind energy property.
- A \$1.6 billion increase in the amount of “new clean renewable energy bonds” authorized under section 54C to a total of \$2.4 billion.
- A \$2.4 billion increase in the amount of “qualified energy conservation bonds” authorized under section 54D to a total of \$3.2 billion.
- A temporary increase in the credit available under section 30C for alternative fuel vehicle refueling property. “For refueling property that is placed in service during 2009 and 2010 but does not relate to hydrogen, the credit rate is

increased from 30 percent to 50 percent of the cost of such property, and the limitation on the amount of the credit is increased from \$30,000 to \$50,000 for depreciable property and from \$1,000 to \$2,000 for other property. For hydrogen-related refueling property that is placed in service during 2009 and 2010, the 30 percent credit rate is not changed, but the limitation on the amount of the credit is increased from \$30,000 to \$200,000.

No Extension of General Business Credit Carryback. It is noteworthy that the Act does not include an extension of the carryback period under section 39(a) for general business credits.

Individual Tax Provisions

Noteworthy changes for individuals in the Act include:

- An increase from 10 percent to 30 percent in the credit rate for amounts paid or incurred for qualified energy efficiency improvements under section 25C, and an increase in the limit on the aggregate amount of such credits to \$1,500 for taxable years beginning in either 2009 or 2010; the extension of the placed-in-service deadline for such property by one year until December 31, 2010; and the repeal of the limitation on the amount of the credit allowed to individuals with respect to expenditures made from subsidized energy financing for nonbusiness energy property under section 25C.
- The removal of the limitations on the section 25D credit for expenditures made for solar water heating property (currently

a \$2,000 limit), small wind property (currently a \$4,000 limit) and geothermal heat pumps (currently a \$2,000 limit); and the repeal of the limitation on the amount of the credit allowed to individuals with respect to expenditures made from subsidized energy financing for residential energy-efficient property under section 25D.

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