Renewable Energy Markets Conference

Atlanta, Georgia

New Drivers of Renewable Energy* (Tax Incentives and Credits)

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*connectedthinking

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The Green Landscape

- U.S. Congress considering major climate change legislation focusing on carbon and carbon pricing
- Significant energy tax provisions in two recently-enacted economic recovery bills allow businesses of all types and sizes to take advantage of nearly $100 billion of tax and other incentives for “going green”
    - Passed in October, the Emergency Economic Stabilization Act of 2008 (EESA) included $17 billion in energy tax provisions
    - Enacted in February, the American Recovery and Reinvestment Act (ARRA) added $60 billion in direct spending and $20 billion in tax incentives for renewable energy and energy efficiency over the next 10 years

Waxman-Markey Bill – American Clean Energy and Security Act of 2009 ("ACES")

- Passed House on June 26, 2009 (219 to 212)
- Establishes cap-and-trade program beginning in 2012 covering seven specified gas categories and other determined by EPA
- Compliance obligations generally would be imposed upon
  - Fuel producers and importers – petroleum- or coal-based liquid fuel, petroleum coke, or natural gas liquid
  - Local distribution companies – natural gas
  - Electricity generators
  - Fluorinated gas producers or importers
  - Geological sequestration sites (e.g., coal seam vents)
  - Certain industrial stationary sources
- Senate action underway with possible mark-up in September or October

Tax Issues Arising From Emissions Trading: An End-User's Perspective

- Does receipt of a freely allocated allowance create taxable income?
  - US precedents from the "Acid Rain Program" say "no," but with no analysis
  - The Australian Tax Office proposed to treat such receipts as taxable but has since backed off
- What sort of asset is an emissions allowance? Intangible? Commodity? Something new?
  - US private guidance calls it an "operating intangible"
  - This cures some issues (no passive income under US CFC rules) but may create others (ordinary income versus capital gains and depreciation)
- Does a company that voluntarily buys carbon credits to offset its emissions get a current deduction for the expense?
- Should carbon credits be treated as inventory (dealer versus use in business)?
- Does differing characterization across jurisdictions present double-tax risk that is unaddressed by treaties?

Tax Issues Arising From Emissions Trading: A Financial Intermediary's Perspective

- Can investors trade in emissions allowances without creating a taxable permanent establishment?
  - UK guidance extends its investment manager exemption to carbon trading
  - US guidance on its trading safe harbor is unclear; under current law, a favorable answer would require IRS to treat allowances as "commodities"
- What does it mean to become a "dealer" in emissions allowances?
- Should emissions allowances be characterized the same way for traders as they are for end users?
  - Differing treatment may facilitate favorable rules for traders that provide depth and liquidity to emissions trading markets
  - Differences in treatment also may facilitate tax arbitrage opportunities

Using Tax Incentives to Support Your Carbon Strategy

- Tax credits/deductions incentivize renewable investments and energy saving improvements:
  - Production Tax Credits (PTC) for renewable electricity (Section 45)
  - Investment Tax Credit (ITC) for renewable energy property (Section 48)
  - New cash grants in lieu of energy credits (PTC or ITC)
  - New election to claim ITC in lieu of PTC
  - New credit for “advanced energy manufacturing” property
  - Accelerated deduction for energy-efficient commercial building improvements
  - Alternative fuel credits (e.g., for biodiesel)
  - New grants (non-tax) administered by Dept. of Energy and other agencies
  - Hundreds of different state and local incentive programs

Renewable Energy Production Tax Credits (PTC)

- Generated from the production of energy from certain renewable sources
- The credit is based upon kilowatt hours that are:
  - Produced by the taxpayer
  - From a *qualified energy resource*
  - At a *qualified facility* during the 10 years following the placed-in service date (definitions differ among the various types of energy)
  - Sold by the taxpayer to an unrelated person (although sales to a member of an affiliated group is allowable)
- The credit is 1.5 cents per kilowatt
- Considered a general business credit eligible for one year carryback and 20 year carryforward but credit is nonrefundable
- Credit amount reduced by amount of any subsidized financing received

Qualified PTC Energy Production Resources (including placed-in-service requirements)

- Wind (placed-in-service before 2013)
- Biomass (open- and closed-loop) (placed in service before 2014)
- Geothermal (before 2014)
- Hydropower (before 2014)
- Marine (waves and tides) (before 2014)
- Municipal solid waste including landfill gas (before 2014)
- Refined coal including steel industry fuel (before 2010)

Energy Property Investment Tax Credits (ITC)

- Provides an investment tax credit for energy property as a percentage of the property's basis:
  - **Solar** providing either electricity or light inside a structure (30% credit through 2016)
  - **Geothermal** (either 10% without placed-in-service date, or 30% credit through 2013; see below)
  - **Fuel cell** (30% credit through 2016, capped at $1,500 per half-kilowatt of capacity)
  - **Microturbine** (defined as less than 2,000 kilowatts) (10% credit through 2016, capped at $200 per kilowatt of capacity)
  - **Small wind** (defined as 100 kilowatts or less) (30% credit through 2016, with no credit cap for tax years after 2008)
  - **Combined heat and power systems** (10% credit through 2016)
- After December 31, 2008, the property's basis is not required to be reduced by the amount that the Section 48 credit is subsidized by energy financing under a federal, state, or local program
- Considered a general business credit eligible for one year carryback and 20 year carryforward but credit is nonrefundable

Grants in Lieu of Energy Credits

ARRA creates a new “grant” program option in lieu of the Section 45 energy production credit or the Section 48 energy investment credit.

- The grant amount is 30 percent of the depreciable or amortizable basis of the energy property in the case of wind, biomass, Section 45 geothermal, solar, landfill, gas, trash, hydro, marine, qualified fuel cell, or small wind property
- The grant amount is 10 percent for microturbine, combined heat and power, small irrigation, section 48 geothermal, and geothermal heat pump
- The basis of the underlying property must be reduced by 50 percent of the amount of the grant
- The grant program will be administered by the Treasury Secretary
- Consideration: Construction risks associated with "placed-in-service" requirement
- Filing and other requirements

Election to Claim ITC in Lieu of PTC

ARRA provides an election allowing qualified PTC facilities (other than solar, refined coal, or Indian coal) to elect the 30 percent ITC in lieu of the production credit

- The election applies to the eligible basis of depreciable (or amortizable) qualified Section 45 property placed in service between January 1, 2009 and December 31, 2013 (December 31, 2012 for wind facilities)
- Qualifying property must be tangible personal property or other tangible property not including a building or its structural components if such property is integral to the facility
- Consideration: day-one tax benefits vs. year-over-year production credits

New “Advanced Energy Manufacturing” Credit

ARRA provides a new 30 percent investment credit for qualified property used in a qualified advanced energy manufacturing project

- Applies to construction, reconstruction, or erection of tangible personal property and other tangible property (not including a building or its structural components) completed by the taxpayer after October 31, 2008 and used to manufacture components for the production of renewable energy, advanced battery technology, and other innovative next-generation green technologies
- The basis of the qualified property must be reduced by the amount of the credit received
- Treasury has been allocated over $2.3 billion to fund the credit-eligible projects that meet specific criteria as certified by the Treasury
- Guidance released sets extremely tight time lines: preliminary applications to DOE by September 16, 2009; final applications to DOE by October 16, 2009, and a separate application for certification to the IRS by December 16, 2009
- A second round of applications may be considered

Now What? Steps to Obtaining Green Tax Incentives

Many of the new green tax incentives require registration with the IRS or application to the Department of the Treasury.

As a result, these programs may require additional tax compliance measures or new administrative efforts. This can include:

- Determining initial eligibility for an incentive program based on current or planned operations
- Filing proper IRS registration documents and subsequent weekly, quarterly or annual forms to claim alternative fuel payments
- Assembling the Treasury application required for the grant-in-lieu-of credit program
- Obtaining project certification from Treasury required for the Advanced Energy Manufacturing Base Investment Credit

What’s Next in Energy Legislation

- House passed cap-and-trade and other energy provisions legislation on June 26
- Senate Environment and Public Works Committee targeting September for mark-up of its own climate change/carbon legislation
- Senate Majority Leader Reid set forth proposed schedule:
  - Other committees have until roughly end of September to consider changes to Environment and Public Works Committee bill
  - Floor debate possible in November
  - Would require conference with House later in the year
- Several energy tax items considered in stimulus debate may resurface (smart grids, energy research credit, electrical grid upgrades)

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