

Congress Extends Expiring Renewable Energy Grant for One Year

Bonus Depreciation Expanded and Biofuels Credits Also Extended

As reported in prior Arnold & Porter LLP advisories, the February 2009 American Recovery and Reinvestment Act (the Stimulus Law) contained for the first time an outright federal government cash grant for renewable energy projects.¹ The grant was equal to 30 percent of the cost of eligible equipment and could be chosen by project developers and financiers instead of the traditional subsidies in the form of investment tax credits. Since this grant was conceived as a stimulus measure, the property had to be placed in service during 2009 or 2010; or if not placed in service by the end of 2010, construction must have commenced by the end of 2010. As reported in more detail below, the deadline for commencing construction has been extended for one year.

Progress of the Grant Program

This grant program began slowly since the US Department of the Treasury (Treasury Department), which administers the program, did not pass final guidelines for several months and did not begin accepting applications until July 31, 2009. However, once the program was underway, it proved to be very popular with developers and financiers. The 30 percent cash grant significantly reduces the cost of capital for renewable energy projects. According to the Treasury Department, 1,647 applicants have received grants amounting to \$5.795 billion as of mid-December 2010.² The great majority of grants (over 82 percent) have been for larger scale wind projects, followed by solar electric (10.8 percent), geothermal (4.1 percent), small scale wind (1.3 percent), and biomass (1.2 percent).

Given the results of the congressional elections in November 2010, there was widespread pessimism in the renewable energy industry about whether or not the grant program would be extended. With the program scheduled to expire at the end of 2010, developers worked frenetically to commence construction by that deadline under Treasury guidelines. The guidelines required that “physical work of a significant nature” begin by the end of 2010 or that 5 percent of the total cost of the property be paid or incurred by the end of 2010, the latter being referred to as the “safe harbor”.³

Contacts



Frederick R. Fucci
+1 212.715.1323



Michael A. Lee
+1 202.942.5757

US Treasury Circular 230 Notice

Any US federal tax advice included in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding US federal tax-related penalties or (ii) promoting, marketing, or recommending to another party any tax-related matter addressed herein.

Extension of the Deadlines

A one-year extension of the grant program (along with numerous other expired or expiring tax provisions) was added to the bill extending the Bush-era tax rate cuts, which was negotiated by President Obama and Congress. Under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Tax Relief Act),⁴ which was signed into law by President Obama on December 17, 2010, the deadline for placing in service qualified renewable energy projects or for commencing construction has been extended to December 31, 2011.⁵ Renewable energy project developers thus will have an extra year to take advantage of the grants in lieu of tax credits. In addition, the deadline for submitting applications has been extended from October 1, 2011 to October 1, 2012.

Credit Termination Dates Not Extended

The Tax Relief Act does not, however, change the deadlines established under the Stimulus Law for when the equipment must be placed in service, known as the “Credit Termination Dates.” The nearest credit termination date is **January 1, 2013** for large-scale wind projects. In other words, if construction commences by the end of 2011, the equipment must be placed in service by the end of 2012 for the equipment to qualify for the 30 percent grant (as well as the investment tax credit). This is a short deadline for large-scale wind turbines and farms. The credit termination dates for other categories of renewables are:

January 1, 2014: Biomass, Geothermal (under IRC §45), Landfill Gas, Waste, Incremental Hydropower and Marine and Hydrokinetic.

January 1, 2017: Solar, Geothermal (under IRC §48), Fuel Cells, microturbines, combined heat and power, small wind and geothermal heat pumps.⁶

Treasury Guidance on Commencement of Construction Unaltered

The Tax Relief Act also does not make reference to any of the guidelines issued by the Treasury Department for the implementation of the grant program. As a result, the same considerations going into what it means to have commenced

construction by the end of 2010 should apply when the deadline approaches again at the end of 2011.⁷

Bonus Depreciation Extended and Increased to 100 percent in 2011

The Tax Relief Act extends and temporarily increases first-year bonus depreciation for investment in certain equipment,⁸ which potentially includes renewable energy property. For qualifying property, the Act provides for 100 percent bonus depreciation, meaning the entire cost of the equipment may be deducted in the year it is placed in service. To qualify for this 100 percent first-year bonus depreciation, property generally must meet the following requirements:

- It must have the Modified Accelerated Cost Recovery System apply and a recovery period of 20 years or less;
- Its original use must commence with the taxpayer after September 8, 2010;
- It must be acquired by the taxpayer after September 8, 2010 and before January 1, 2012, and there cannot have been a binding contract for acquisition of the property in effect before January 1, 2008; and
- It must be placed in service before January 1, 2012 (or January 1, 2013, for certain long-lived property with long production periods).

For qualifying property placed in service in 2012 (and acquired any time after 2007, not necessarily before September 8, 2010), the bonus depreciation reverts to 50 percent, which is the rate in effect for 2010.⁹ The Act also allows taxpayers to elect to accelerate certain Alternative Minimum Tax credits in lieu of taking bonus depreciation for taxable years 2011 and 2012.

Bonus depreciation is not available for property that must be depreciated under the Alternative Depreciation System, which generally includes property leased to governmental entities or tax-exempt organizations, property financed with tax-exempt bonds, and property used predominantly outside the United States.

Bonus depreciation can potentially apply to renewable energy property. If the owner claims the investment tax credit

or receives a cash grant in lieu of the credit, the property's basis will be reduced by that amount, thereby reducing the amount of first-year bonus depreciation that may be claimed. Bonus depreciation itself will reduce the property's basis and thereby reduce the amount of depreciation deducted after the first year.

The window of eligibility for 100 percent first-year bonus depreciation is rather narrow for renewable energy property developers. However, even if the property cannot be placed in service until 2012, 50 percent bonus depreciation will still provide a significant tax benefit.

Retroactive Extension of Biodiesel and Renewable Diesel Credits

Prior to the Tax Relief Act, credits for certain types of biodiesel sold or used in the US¹⁰ did not apply to fuel sold or used after December 31, 2009. The credits were for:

- Biodiesel, which is fuel made from plant or animal matter meeting certain US Environmental Protection Agency (EPA) and ASTM requirements;¹¹ the credit was \$1.00 for each gallon of biodiesel (not in a mixture with standard diesel fuel) used by a taxpayer in a trade or business or sold by the taxpayer at retail to a person (into the fuel tank of such person's vehicle);¹²
- Qualified biodiesel mixtures, which is a mixture of biodiesel and normal diesel fuel; the credit was \$1.00 for each gallon of biodiesel used by a taxpayer in the production of a qualified biodiesel mixture and sold to any person for use as fuel or used by the producing taxpayer;
- Renewable diesel, which is liquid fuel derived from biomass meeting certain EPA and ASTM requirements and having such uses as diesel fuel, fuel oil for furnaces, military jet fuel and others; and
- Small agri-biodiesel producer income tax credit, which is 10 cents per gallon for up to 15 million gallons produced by small producers, defined to be persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year.¹³

The Tax Relief Act retroactively extends all the above credits and payments through December 31, 2011, meaning that the credits now apply to sales or use in 2010 and 2011.¹⁴ Due to the retroactive nature of the provision, the relevant section directs the secretary of the Treasury to issue guidance by January 16, 2011 that will allow persons to make biodiesel credit claims for 2010 starting in mid-February through mid-August 2011.

We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

Frederick R. Fucci
+1 212.715.1323
Fred.Fucci@aporter.com

Michael A. Lee
+1 202.942.5757
Michael.Lee@aporter.com

(Endnotes)

- 1 P.L. 111-5. The prior advisories are *Tremendous Support for Renewable Energy and Efficiency in the Stimulus Law* (March 2009), available at: http://www.arnoldporter.com/resources/documents/CA_TremendousSupportForRenewableEnergy_031109.pdf and *Federal Cash Grant Program for Renewable Energy Property Now in Effect* (August 2009), available at: http://www.arnoldporter.com/resources/documents/Advisory-FederalCashGrantProgramForRenewableEnergy_073109.pdf.
- 2 See: <http://www.treasury.gov/initiatives/recovery/Pages/1603.aspx>.
- 3 See: *Payments for Specified Energy Property in Lieu of Tax Credits under the AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009*, US Department of the Treasury, Office of the Fiscal Assistant Secretary, (July 2009, revised March 2010).
- 4 P.L. 111-312.
- 5 Tax Relief Act, §707 (Extension of Grants for Specified Energy Property in Lieu of Tax Credits).
- 6 Combined heat and power equipment, microturbines and geothermal heat pumps are only eligible for 10 percent of the qualified cost as a grant in lieu of tax credit.
- 7 These considerations are discussed in our prior advisory referred to in Note 1 above, as well as in the Treasury guidelines referred to in Note 3 above.
- 8 Tax Relief Act, § 401.
- 9 Bonus depreciation expired at the end of 2009 but was extended through 2010 by the Small Business Jobs Act of 2010.
- 10 Internal Revenue Code of 1986, as amended (the Code), §40A.

ARNOLD & PORTER LLP

- 11 Biodiesel is defined as monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the EPA under Section 211 of the Clean Air Act (42 U.S.C. §7545) and (2) the requirements of the ASTM D6751. *See: Technical Explanation of the Revenue Provisions Contained in the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creating Act of 2010" Schedule for Consideration by the United States Senate*, prepared by the Staff of the Joint Committee on Taxation, December 10, 2010 (the Joint Committee Report), p. 65.
- 12 The incentive may be taken as an income tax credit, an excise tax credit or as a payment from the Secretary of the Treasury. *See: the Joint Committee Report*, p. 67, citing Secs. 40A(f), 6426(c) and 6427(e) of the Code.
- 13 Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, camelina, or animal fats. Joint Committee Report, p. 65.
- 14 Tax Relief Act, §701, Incentives for Biodiesel and Renewable Diesel.

© 2010 Arnold & Porter LLP. This advisory is intended to be a general summary of the law and does not constitute legal advice. You should consult with counsel to determine applicable legal requirements in a specific fact situation.