

Client Alert

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The American Recovery and Reinvestment Act of 2009—Renewable Energy Tax Incentives

On Wednesday, February 11, Congressional leaders agreed to a compromise economic stimulus bill, the American Recovery and Reinvestment Act of 2009 (ARRA or the Bill). The House and Senate are expected to approve this version of ARRA and the legislation will likely be signed by President Obama before Presidents' Day, Monday, February 16.

The Bill includes a number of incentives designed to encourage expenditures on renewable energy and other more general provisions that may affect investments in renewable energy projects. The Bill incorporates elements of both the House and Senate proposals (which were the subject of our memoranda circulated January 18 and January 26).

Provisions specifically addressing renewable energy include:

- PTC Extension – The section 45 “production tax credit” will be extended to otherwise qualified facilities that are placed in service before
 - January 1, 2013 in the case of wind facilities; and
 - January 1, 2014 in the case of closed and open-loop biomass, geothermal, solar, landfill gas, municipal solid waste, hydroelectric and marine and hydrokinetic renewable energy facilities.

The PTC for small irrigation power, refined coal production and Indian coal production facilities will not be extended.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Tax Group, whose names and contact information are provided herein.

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- ETC Election – In the case of any facility of the type described above for which the PTC expiration date will be extended that is placed in service after December 31, 2008 and prior to the relevant PTC expiration date, the Bill will permit taxpayers to make an irrevocable election to claim the 30% energy tax credit in lieu of PTCs. In the case of a facility owned by a partnership, it appears that this election would need to be made by the partnership and would apply to all of the partners of the partnership. The rules currently applicable to lessees and lessors of energy credit property would also apply, *i.e.*, lessors could elect to pass through the credit to lessees and the “3-month sale leaseback rule” would apply in determining whether a lessor originally placed the property in service.
- Cash Grants in Lieu of Tax Credits – The Bill requires the Treasury Department to provide cash grants to applicants who place in service certain renewable energy facilities that would otherwise qualify for the ETC (including those PTC-eligible facilities for which taxpayers are able to elect to claim the ETC). In general, the grant amount is 30% of the basis of the property. For qualified microturbine, combined heat and power system, and geothermal heat pump property, the amount is 10% of the basis of the property. To be eligible, the facility must (1) be placed in service in 2009 or 2010, or (2) construction of the facility must begin in 2009 or 2010 and the facility must be placed in service, in the case of facilities described under the heading “PTC Extension” above, before the dates described under that heading, and in the case of solar energy property, qualified fuel cell property and other property eligible for ETCs under current law, before January 1, 2017. No PTCs or ETC can be claimed for facilities for which a grant was made. The Treasury Department grants will not be taxable income to the taxpayer, but the depreciable basis of the property for which grants are received will need to be reduced in the same manner as if the ETC had been claimed, *i.e.*, by 50% of the grant.
- Repeal Subsidized Energy Financing Limitation – The requirement that the amount of the allowable ETC be reduced in the case of facilities financed in whole or in part with the proceeds of tax-exempt bonds or federal, state or local financing programs designed to conserve or produce energy will be repealed. Note that the comparable provision relating to the amount of allowable PTCs will continue in effect, but not with respect to facilities in respect of which taxpayers have elected to claim the ETC in lieu of PTCs.
- Increased Amount of CREBs and QECCBs – The \$800 million national limits on the amount of Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds that can be issued pursuant to sections 54C and 54D of the Internal Revenue Code will be increased by \$1.6 billion in the case of CREBs and \$2.4 billion in the case of QECCBs.
- Other Energy Incentives – The Bill makes a number of other changes to existing law, including increases in the credits available to individuals for amounts spent for energy efficiency and renewable energy for non-business property and increases in the credit for alternative fuel vehicle refueling property.

The proposed legislation includes a number of other changes to federal income tax law that may affect the economics of investments in renewable energy projects. These include:

- Bonus Depreciation – The ability to claim an additional depreciation deduction equal to 50% of the adjusted basis of property will be extended to eligible property placed in service in calendar year 2009 (or, in the case of certain property with longer production periods that is placed in service after 2009, but before January 1, 2011, the adjusted basis of such property attributable to manufacture, production or construction before January 1, 2010).

- Section 179 Election to Expense – The ability to elect to expense up to \$250,000 of capital expenditures for depreciable property will be extended to taxable years beginning in 2009.
- Deferred Recognition of CODI – An issuer that retires its debt at a discount or exchanges its debt for an instrument with a lower value generally recognizes cancellation of indebtedness income (CODI) on the retirement or exchange. Similar rules apply where an issuer's debt is purchased at a discount by a party related to the issuer. The Bill allows borrowers to defer taxes on CODI for 5 years following the date of recognition for the amount of debt cancelled in 2009 and 4 years following the date of recognition for the amount of debt cancelled in 2010. The CODI would then be included ratably over the 5-year period following the deferral period. The change will be effective for debt that is repurchased, exchanged for a new instrument or deemed exchanged for a new instrument after December 31, 2008 and prior to January 1, 2011.

The Bill does not include two significant provisions that could have affected investments in renewable energy property and that were included in earlier versions of this legislation:

- 5-Year NOL Carryback – The normal 2-year limit on a taxpayer's ability to carryback net operating losses is extended to 5 years (or any whole number less than 5 years that the taxpayer elects) for NOLs arising in taxable years ending in 2008 or 2009, but only in the case of businesses with not more than \$15 million of average annual gross receipts. It is reported that, as of this date, this provision continues to be discussed among Congressional leaders.
- 5-Year Business Credit Carryback – Excess business credits (including ETCs and PTCs) may be carried back one taxable year and forward up to 20 taxable years. The Senate's proposal extends to 5 years the carryback period for business credits arising in 2008 and 2009 is not included in the Bill.

Please call either of the undersigned if you have any questions concerning these matters.

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