

Guidance on Energy Tax Credit Election

Hugh M. Dougan • Brian Wainwright

In Notice 2009-52 the Internal Revenue Service has set forth the procedure for taxpayers to claim an energy tax credit in lieu of production tax credits with respect to certain renewable energy facilities, but may have inadvertently cast doubt on the viability of one possible financing technique.

Background

Production Tax Credits

Internal Revenue Code section 45 generally provides an inflation-adjusted tax credit for each kilowatt-hour of electricity produced from qualifying sources and sold to unrelated parties. Qualifying sources are wind and “Other PTC Sources,” closed-loop biomass, open-loop biomass, geothermal, solar, small irrigation power, landfill gas, trash combustion, qualified hydropower and marine and hydrokinetic.

Production tax credits are generally available for ten years after the qualifying property is placed in service, and are reduced, but by no more than ½ (50 percent), to account for government grants, proceeds of tax-exempt bonds and other credits.

For 2009 the production tax credit amount is 2.1 cents per kilowatt-hour for wind, closed-loop biomass, geothermal and solar and 1.1 cents per kilowatt-hour for open-loop biomass, small irrigation power, landfill gas, trash combustion, qualified hydropower and marine and hydrokinetic.

Under the American Recovery and Reinvestment Tax Act of 2009 (the “2009 Act”), Division B of P.L. 111-5, the Stimulus Act, the placed-in-service deadline for wind facilities has been extended to December 31, 2012 and the placed-in-service deadline for Other PTC Sources has been extended to December 31, 2013.¹

Energy Tax Credits

Internal Revenue Code section 48 provides an investment-type credit for the eligible basis of energy property placed in service during the taxable year. Energy property was previously defined to include only solar, geothermal, qualified fuel cell and microturbine. The

amount of the energy tax credit is 30 percent of eligible basis for solar and qualified fuel cell and ten percent for geothermal and microturbine. In addition, the energy tax credit for qualified fuel cell had been limited to \$500 for each ½ kilowatt of capacity.

The property’s eligible basis had been reduced by the portion of that basis attributable to subsidized energy financing or proceeds of private activity (tax-exempt) bonds. The depreciable basis of property for which the energy tax credit is claimed is reduced by ½ (50 percent) of the credit.

For qualifying property that has a normal construction period of at least two years, energy tax credits may be claimed on the basis of “progress expenditures” made during construction of the property, rather than when the constructed property is finally placed in service. And if energy tax credit property is disposed of within five years after having been placed in service, energy tax credits previously claimed with respect to the property are “recaptured.” In those circumstances, the tax for the year of disposition is increased by a portion of those previously claimed credits, depending upon the amount of time from the property’s being placed in service to its disposition.

The Energy Improvement and Extension Act of 2008 (the “2008 Act”), Division B of P.L. 110-343, the Bailout or TARP Act, revised the energy tax credit by

- adding small wind (with a 30 percent credit), combined heat and power (cogeneration) systems (with a ten percent credit) and geothermal heat pumps (also with a ten percent credit),
- extending the placed-in-service deadline to December 31, 2016 for solar, qualified fuel cell and microturbine,

Hugh M. Dougan and Brian Wainwright are tax partners in the New York and Palo Alto offices, respectively, of Pillsbury Winthrop Shaw Pittman LLP. This article can also be found as part of the Pillsbury Winthrop Shaw Pittman LLP Tax Page. See Available Material for links to the administrative and legislative material discussed in this bulletin. See also Important Notice to Readers.

¹ The placed-in-service deadline was not extended for refined coal and Indian coal.

- raising the limitation for qualified fuel cell from \$500 to \$1,500 per ½ kilowatt of capacity,
- eliminating the exclusion of “public utility property” and
- allowing energy tax credits to be used against the alternative minimum tax.²

In addition, the 2009 Act eliminates the reduction of the energy tax credit base for subsidized energy financing and proceeds of private activity bonds, effective January 1, 2009.

Energy Tax Credits in Lieu of Production Tax Credits

The 2009 Act allows taxpayers to elect a 30 percent energy tax credit for the eligible basis of a “qualified investment credit facility,” defined as a wind facility qualifying for the production tax credit placed in service in 2009 through 2012 and any Other PTC Source facility placed in service in 2009 through 2013. This election is not available if production tax credits have previously been allowed for the facility. And once the election is made, production tax credits are no longer available for the facility.

The regular energy tax credit recapture and progress expenditure rules apply. And the depreciable basis of the property is reduced by ½ (50 percent) of the energy tax credit.

2009 Act Cash Grant in Lieu of Energy Tax Credit

Under section 1603 of the 2009 Act, grants from the U.S. Treasury are available for energy tax credit eligible property (including production tax credit property eligible for the energy tax credit in lieu of the production tax credit) placed in service in 2009 or 2010, or construction of which begins in 2009 or 2010 and which is placed in service by the “grant termination date,” defined as December 31, 2012 for wind production tax credit property, December 31, 2013 for Other PTC Source facilities and December 31, 2016 for other energy tax credit property.

The grant amount is 30 percent of the eligible basis for production tax credit property and solar, qualified fuel cell and small wind energy tax credit property. The grant amount is ten percent of eligible basis for other energy tax credit property. Any applicable energy tax

credit dollar limitations also apply to grants (e.g., \$1,500 per ½ kilowatt of capacity for qualified fuel cell).

The U.S. Treasury is required to make grants within 60 days of the latter of application or the property being placed in service. Applications must be made on or before September 30, 2011.

Although the grants are not income, rules “similar to” the normal energy tax credit recapture rules are to apply and the basis reduction (½ of credit) rules also apply.³ Neither production nor energy tax credits are available for grant property. Importantly, the statute provides that any prior production or energy tax credits claimed with respect to grant property are also recaptured. Finally, grants are not available for non-taxpayers (e.g., federal, state and local governments and 501(c) organizations) or for partnerships having any non-taxpayer partners.

Notice 2009-52

Notice 2009-52 provides the procedure by which a taxpayer may elect to claim the energy tax credit (referred to in the Notice as the “investment tax credit”) in lieu of production tax credits with respect to property that is an integral part of a qualified facility. The taxpayer may claim the energy tax credit on a completed Form 3468 filed with the taxpayer’s timely filed (taking into account extensions) federal income tax return for the taxable year that the facility is placed in service. Notice 2009-52 also specifies information that must be contained in an attachment to Form 3468, including a statement that the taxpayer “has not and will not” claim a cash grant under section 1603 of the 2009 Act (referred to in the Notice as a “Section 1603 Grant”) for the property for which the energy tax credit is being claimed.

The Issue

As noted above under *Background—2009 Act Cash Grant in Lieu of Energy Tax Credit*, cash grants cannot be made any earlier than the date the qualifying property is placed in service and, accordingly, a potential cash grant cannot provide financial assistance during the construction of a qualifying project. However, as noted above under *Background—Energy Tax Credits*, the energy tax credit may be claimed on a “progress expenditure” basis for projects having a “normal construction period”

² See *Energy Tax Highlights from the Economic Rescue Act* in our **November 2008 Tax Bulletin** for more information on the energy tax provisions of the 2008 Act.

³ The authors understand that current Internal Revenue Service thinking is that grant recapture should require only return of all or a portion of the grant and should not also trigger a special increase in tax (as occurs with energy tax credit recapture).

of at least two years.⁴ Finally, Internal Revenue Code section 48(d)(2), as added by the 2009 Act and captioned “Recapture of Credits for Progress Expenditures Made Before Grant,” provides that if a “credit was determined under this section with respect to such property for any taxable year ending before such grant is made,” there shall be a recapture of tax in an amount equal to such previously determined credit. Thus, it was clearly intended that, for a qualifying long-term project, a taxpayer could claim energy tax credits under Internal Revenue Code section 48(b) on a “progress expenditure” basis during construction, and a cash grant in the year the property is placed in service.

Putting these provisions together, for an appropriate long-term project a taxpayer might claim the energy tax credit on a “progress expenditure” basis under Internal Revenue Code section 48(b) during construction, with a view to claiming a cash grant under section 1603 of the 2009 Act in the year the property is placed in service—suffering, at that time, a recapture of the energy tax credits previously claimed. Such an approach could provide effective financial assistance, equivalent to the cash grant, during construction of the project.

Notice 2009-52 creates some doubt as to the efficacy of this strategy, in a way that was probably not intended. By omitting any specific procedure for claiming energy tax credits on a “progress expenditure” basis under Internal Revenue Code section 48(b), the Notice may create the impression that such progress expenditure credits may be claimed only by the filing of the prescribed Form 3468, accompanied by an “irrevocable election” not to apply for a cash grant under section 1603 of the 2009 Act once the qualified project is placed in service. This result would be directly contrary to the Congressional intent underlying Internal Revenue Code section 48(d)(2), providing for recapture of energy tax credits previously determined upon the claiming of a cash grant in the year the project is placed in service.

Further guidance from the Internal Revenue Service is needed for taxpayers to take full advantage of the progress expenditure rules for energy tax credits. For example, in the case of an integrated “windfarm” energy project, consisting of wind study and site development

expenditures, 500 wind turbines (including towers and foundations), a system of gathering electric lines connected to a central monitoring and regulating control station, a further connection to a central switchyard, and dispatch from that location to an electric transmission grid, the Internal Revenue Service needs to confirm that (despite some earlier ruling precedents) this project will be treated as a single “property,” having an extended construction period, and not as 500 separate “properties,” each requiring a far shorter individual construction period. The Internal Revenue Service also needs to clarify the related question of what components of such a project will be considered facilities that qualify for cash grants.⁵

Possible Clarification

One way the Internal Revenue Service might clarify Notice 2009-52 would be to indicate that under Internal Revenue Code section 48(b), energy tax credits may be claimed for a qualifying project on the basis of “progress expenditures” without the filing of the prescribed Form 3468 (or at least without the required accompanying “irrevocable election” described in the Notice not to claim a cash grant). The clarification might, however, provide that to preserve this treatment a taxpayer must file the Form 3468 (with the irrevocable election) for the taxable year in which the project is placed in service. This approach would leave the taxpayer free to claim a cash grant in that year instead, as Internal Revenue Code section 48(d)(2) clearly seems to contemplate.

Available Material

The following administrative and legislative material is available with the indicated file sizes:

- **Notice 2009-52** [17.1K],
- **American Recovery and Reinvestment Tax Act of 2009, Division B of P.L. 111-5, § 1104**, adding I.R.C. § 48(d) [27.5K],
- **American Recovery and Reinvestment Tax Act of 2009, Division B of P.L. 111-5, § 1603**, providing for cash grants in lieu of energy tax credits [37.1K] and
- **I.R.C. §§ 46(c)(4), 46(d)**, as in effect prior to amendment by the Revenue Reconciliation Act of 1990 (P.L. 101-508) [76.2K]

⁴ Specifically, Internal Revenue Code section 48(b) provides that rules similar to the rules of subsections (c)(4) and (d) of Internal Revenue Code section 46 (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) apply for purposes of the energy tax credit. See *Available Material* for a link to the text of those subsections as then in effect.

⁵ The authors understand that the Internal Revenue Service intends to address these and other “scope” issues in forthcoming guidance on the cash grant option.

Important Notice to Readers

This material is not intended to constitute a complete analysis of all tax considerations. Internal Revenue Service regulations generally provide that, for the purpose of avoiding United States federal tax penalties, a taxpayer may rely only on formal written opinions meeting specific regulatory requirements. This material does not meet those requirements. Accordingly, this material was not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal or other tax penalties or of promoting, marketing or recommending to another party any tax-related matters.