

## ADVISORY | Clean Energy and Climate

March 16, 2010

### GOVERNMENT INCENTIVES FOR RENEWABLE ENERGY - AN UPDATE

In the past few years, Congress enacted or extended several incentives, in the form of tax credits or cash grants, available for taxpayers involved in the production of renewable energy. As discussed below, many of these incentives could potentially be renewed or expanded, clarified, or, in some cases, limited.

#### INCENTIVES FOR ENERGY PRODUCING FACILITIES

##### Production Credit

Taxpayers may claim a tax credit (generally 1.5 cents per kilowatt hour of electricity produced) under current law for producing renewable electricity at a qualified facility during a specified period.<sup>1</sup> Qualified facilities include wind facilities, closed-loop and open-loop biomass facilities, geothermal or solar energy facilities, small irrigation power facilities, landfill gas or trash facilities, refined coal and Indian coal production facilities, hydropower facilities, and marine and hydrokinetic renewable energy facilities. Qualified property must be placed in service by a specified date (i.e., the placed-in-service limitation date) in order to be eligible for the credit. The credit generally is available for a ten-year period beginning on the date that the property is placed in service.

The Senate in 2010 passed an amendment to the House's version of the tax-extendors bill.<sup>2</sup> The Senate amendment<sup>3</sup> would extend the placed-in-service limitation date for refined coal production facilities from December 31, 2009 to December 31, 2010. The small irrigation power facilities and Indian coal production facilities both have placed-in-service limitation dates that expired prior to 2009 and would not be renewed or extended by the Senate amendment. The placed-in-service limitation date for wind facilities is December 31, 2012, and for all other eligible Section 45 facilities is December 31, 2013. The placed-in-service limitation dates for these facilities would not be extended under the current bill before Congress.

##### Investment Tax Credit

Taxpayers may claim a tax credit under current law for the costs of investment in certain specified energy producing property (generally 30 percent of the costs).<sup>4</sup> The investment tax credit is allowed in lieu of the production credit for facilities that would otherwise qualify for the production credit, other than small irrigation power facilities, refined coal production facilities, and Indian coal production facilities (for which no investment tax credit is allowed). To qualify for the investment tax credit, qualifying property must meet the same placed-in-service date limitations that are applicable for purposes of the production credit. Taxpayers may also claim the investment tax credit for certain

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<sup>1</sup> Section 45 of the Internal Revenue Code of 1986, as amended (the "Code"). Unless otherwise indicated, all section references are to the Code.

<sup>2</sup> H.R. 4213, 111th Cong. (2009).

<sup>3</sup> H.R. 4213, 111th Cong. (2010).

<sup>4</sup> Section 48.

limited categories of facilities that are not eligible for the production credit, such as qualified fuel cell property, qualified microturbine property, combined heat and power system property, and qualified small wind energy property. There are no pending legislative or executive proposals that would impact the investment tax credit.

### Section 1603 Grants

Taxpayers may apply under current law for a grant (a “Section 1603 grant”) in lieu of the production credit or investment tax credit.<sup>5</sup> Treasury must pay grants to grant applicants who meet the terms of the legislation. The grant, like the investment tax credit, generally is 30 percent of the taxpayer’s qualifying costs for qualifying property. Section 1603 grants are not includible in the gross income of the recipient.

Properties eligible for Section 1603 grants are the same properties that are eligible for the investment tax credit. However, grants are available only for (1) qualifying property placed in service during 2009 or 2010, or (2) qualifying property (i) the construction of which begins pursuant to a binding written contract in 2009 or 2010, and (ii) which is placed in service by December 31, 2012 in the case of wind facilities and December 31, 2013 in the case of most other property (including most solar property). To be eligible, grant applications must be received by October 1, 2011.

Neither President Obama’s budget nor the Senate or House extenders bills have proposed to extend the credit period for the Section 1603 grants. While other Members of Congress have proposed extensions,<sup>6</sup> there is no indication currently that these would be adopted. Thus, taxpayers seeking the grant should ensure that, with respect to any facilities to be completed after 2010, they have in place binding construction contracts and begin significant construction activities this year.

In a controversial move, Senator Schumer on March 3, 2010, introduced legislation in the Senate that would require any property eligible for the Section 1603 grant to satisfy the “Buy American” provision of the ARRA.<sup>7</sup> Subject to some exceptions, the Buy American provision generally prohibits appropriated funds from being used on an infrastructure project “unless all of the iron, steel, and manufactured goods used in the project are produced in the United States.”<sup>8</sup> Adoption of this legislation would reverse Treasury’s current policy position that the Buy American provision does not apply to the Section 1603 grant program. As introduced, this legislation would affect only the Section 1603 grant program, and thus would not impact the property’s eligibility for any other incentive programs, including the production credit or investment tax credit.

### INCENTIVE FOR MANUFACTURE OF CERTAIN PROPERTY USED IN ENERGY PRODUCING FACILITIES

Taxpayers may claim a discretionary income tax credit under current law equal to 30 percent of a taxpayer’s qualifying costs in building or expanding a *manufacturing facility* for the production of specified advanced energy property.<sup>9</sup> Specified advanced energy property includes renewable energy property (e.g., solar, wind, geothermal property), fuel cells, microturbines, smart grid and other efficient energy transmission and storage systems, carbon capture and storage equipment, property for blending of renewable fuels and other energy conservation, and qualified plug-in electric drive vehicles and components. The income tax credit is subject to the discretion of the Secretary of

<sup>5</sup> Section 1603 of Division B of the American Recovery and Reinvestment Act of 2009 (“ARRA”).

<sup>6</sup> S. 2899, 111th Cong. (2009) (proposing to extend the Section 1603 grant through 2012).

<sup>7</sup> S. 3069, 111th Cong. (2010).

<sup>8</sup> For more details on the Buy American provision of the ARRA, please see the Covington Energy Advisory of February 17, 2009, titled “A Summary of Key Energy and Environmental Provisions of the American Recovery and Reinvestment Act of 2009.”

<sup>9</sup> Section 48C.

Treasury, in consultation with the Secretary of Energy, and currently is subject to an overall cap of \$2.3 billion. Projects are certified for the credit based on a variety of criteria, including commercial viability, domestic job creation, net impact in avoiding or reducing greenhouse gas emissions, potential for technological innovation, level of cost of generated or stored energy, and length of time from project certification to completion.

As of January, 2010, the Treasury and the Department of Energy have awarded all of the \$2.3 billion of authorized tax credits. Accordingly, the Section 48C credit has effectively expired. However, President Obama's fiscal year 2011 proposed budget proposes to provide an additional \$5 billion in credits, which would effectively extend the Section 48C credit program.

## SMART GRID INVESTMENT GRANTS

Taxpayers may seek from the Department of Energy a Smart Grid Investment Matching Grant for reimbursement of 20 percent of qualifying smart grid investments under 42 U.S.C. 17386. Grants may cover investments in devices that allow the following types of property to engage in smart grid functions: appliances, specialized electricity using equipment (e.g., motors) installed in industrial or commercial applications, transmission and distribution equipment, metering and other control devices, software, electric or hybrid vehicles, regional electric grids, and generators. Smart grid investment grants are not available for investments in smart grid technologies, investments, or equipment that are eligible for tax credits or deductions under the Code. Appropriations of sums necessary for the smart grid investment grants are authorized through 2012.

The Internal Revenue Service ("IRS") recently confirmed that matching grants from the Department of Energy for qualifying smart grid investments under 42 U.S.C. 17386 are excluded from gross income and are instead treated as non-shareholder contributions to capital.<sup>10</sup> The IRS guidance does not apply to (1) noncorporate taxpayers or (2) grants provided for smart grid research, development, and demonstration, which are available under 42 U.S.C. 17384.

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If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

**Daniel Luchsinger**  
**Dirk Suringa**

202.662.5175  
202.662.5436

[dluchsinger@cov.com](mailto:dluchsinger@cov.com)  
[dsuringa@cov.com](mailto:dsuringa@cov.com)

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<sup>10</sup> Rev. Proc. 2010-20.