

# Federal Tax Subsidies for Renewable Energy Projects

**Laura Hegedus**  
*lhegedus@chadbourne.com*

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London

**There are several federal tax subsidies available to businesses that generate energy from renewable sources.**

**smart developers**

**investment tax credit or production tax credit**

**faster depreciation**

CHADBOURNE  
& PARKE LLP

**“Only buy something that you’d be perfectly happy to hold if the market shut down for 10 years.”**

**— Warren Buffet**

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London

**Production tax credits of 1.0¢ or 1.9¢ a kWh can be claimed for 10 years by anyone generating electricity from wind, biomass, geothermal steam or fluid, landfill gas, garbage or water (in the case of new turbines installed at existing dams). The 10 years are measured from when a plant is first “placed in service.”**

**new plants**

**80/20 test**

**2007 deadline**

**high electricity prices**

CHADBOURNE  
& PARKE LLP

**Be careful about the fuel going into biomass plants. What you think is biomass may not be. The IRS is working on guidance to address what happens if the plant uses a mix of fuels. One of the issues is whether plants should forfeit all credits if they use more than a de minimis amount of material that is not biomass.**

**“co-firing”  
gasify first?**

CHADBOURNE  
& PARKE LLP

**PTCs: The electricity must be sold to an “unrelated person.” Two entities can have up to 50% overlapping ownership without being treated as related. If the electricity generator is a partnership, ownership is tested by looking at both the capital and profits interests that the oftaker has in the partnership.**

**flip structures**

**Production tax credits are subject to a “haircut” of as much as 50% to the extent the project benefits from grants, tax-exempt bonds, subsidized energy financing or “other credits.” The IRS said in February that only other *federal* credits are a problem.**

**refund claims?**

**grant?**

***subsidized* energy financing**

**RECs**

CHADBOURNE  
& PARKE LLP

**ITCs: There is an investment tax credit for 30% of the cost of new equipment that uses solar energy to "generate electricity, to heat or cool (or to provide hot water for use in) a structure, or to provide solar process heat." The credit drops to 10% after 2007.**

**2005 energy act increased from 10% to 30%**

**state payments: reduce basis eligible for federal credit**

**contingent loans?**

**no cap for businesses**

**no utility property**

**CHADBOURNE  
& PARKE LLP**

**ITCs: Tax credit for 10% of the cost of new geothermal equipment.**

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London

**Power plants that generate electricity using wind, sunlight, biomass or geothermal fluid or steam can be depreciated over five years. The tax savings from such depreciation are worth 30¢ per dollar of capital cost. A biomass project must be a "small power QF."**

**The IRS is taking the position that wind farms, biomass projects and other renewable energy projects that qualify for production tax credits must be registered as potential corporate tax shelters. It does not matter whether the developer monetized the credits. The problem is a “trigger” that requires registration of deals where the taxpayer gets more than \$250,000 in tax credits for holding assets for 45 days or less.**

**asset = electricity?**

**deadlines**

CHADBOURNE  
& PARKE LLP

**Solar projects are the most rapidly growing segment of the US market. The US government pays 60% of the capital cost of the typical solar project through investment tax credits and rapid depreciation. Most solar deals are being structured as leases rather than partnership flips.**

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London

**Starting in 2010, companies generating electricity for sale can deduct 9% of their revenue from electricity sales under a special provision meant to encourage “domestic manufacturing.” The deduction is 6% until then.**

**no transmission or distribution  
50% W-2 wage cap**

CHADBOURNE  
& PARKE LLP

# How to Get Value for Tax Subsidies

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London

**The problem with tax subsidies is many project developers do not have enough tax base to use them. Passive loss restrictions and at-risk rules also make them hard for individuals to use. There are various ways to “monetize” the tax subsidies — or receive value for them.**

**There are two main strategies to get value for projects that qualify for production tax credits. One is a partnership flip structure and the other is a lease. Leases work only in biomass projects and not other PTC projects.**

**In a “partnership flip,” the developer brings in an institutional equity investor as a partner to own the project. The investor is allocated nearly all the economic returns until the tax credits have run or, if later, the investor reaches its target return. Then the investor’s interest flips down to single digits.**

**purchase option**

**shared control**

**allocation of tax risk**

**capital account limits**

CHADBOURNE  
& PARKE LLP

**The IRS has put a hold on any further private letter rulings involving partnership flip structures. It appears that what prompted the hold were two ruling requests -- one involving a "guaranteed return" structure and the other involving contingent payments. It is too soon to assess how the market will react.**

**lender or bare purchaser of tax benefits?**

CHADBOURNE  
& PARKE LLP

**Lease structures cannot be used in PTC deals, with the exception of biomass projects. In a biomass deal, the lease is backwards from a normal lease. The lessee gets the production tax credits and deductions for rent that are equivalent to tax depreciation. The lessor keeps the actual tax depreciation and uses it to shelter the rents.**

**A sale-leaseback is probably the best approach for monetizing tax benefits in a project that qualifies for investment tax credits. However, it must be done within three months after the project is originally placed in service.**

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London

**In contrast, when a partnership structure is used to monetize tax credits, the developer must share control over the project — the investor will want a say in any “major decisions” — but it will be less expensive to buy back the project.**

**credits follow taxable income**

**Monetizations can also be done using a “service contract” structure. These are starting to be seen in deals involving municipalities and coops and privately-owned merchant projects.**

**special safe harbor  
prepayment for electricity**

CHADBOURNE  
& PARKE LLP

**“To succeed, jump as quickly at opportunities as you do at conclusions.”**

**— Benjamin Franklin**

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London

**“If at first you don’t succeed, try, try again. Then quit. No use being a damn fool about it.”**

**— W.C. Fields**

CHADBOURNE  
& PARKE LLP

New York • Washington • Houston • Los Angeles • Beijing • Almaty • Tashkent • Moscow • St. Petersburg • Kiev • Warsaw • London