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Energy Tax Provisions Removed from Stimulus; House Introduces Energy Tax Bill

On February 7, 2008, the House and Senate passed a fiscal stimulus package which did not contain an extension of the various energy tax credit provisions. The provisions were dropped after the Senate again failed by one vote to invoke cloture and limit debate on the bill. The President signed the bill into law on February 13, 2008. While the stimulus package does not contain an extension of the tax credits, it contains a bonus depreciation provision which may be applicable to energy tax credit property if the various requirements are met. Details regarding such requirements are provided in the attached Client Alert.

On February 13, 2008, House Ways & Means Committee Chairman Rangel introduced the "Renewable Energy and Energy Conservation Tax Act of 2008" (the "House Bill"). The provisions of the House Bill are substantially similar (but not identical) to the provisions contained in the energy bill passed by the House of Representatives last December. Again, the extension of the various energy tax provisions is funded, in part, by revenue raised through a repeal or reduction in tax incentives that are available to oil and gas companies. The House may vote on this legislation the week after the Presidents Day recess (the week of February 25th). However, in light of prior opposition in the Senate and by the President to the proposed revenue raiser, the outlook on the enactment of these energy tax incentive provisions continues to be uncertain.

Section 45 Provisions

Extension of Placed in Service Date

The placed in service deadline for most qualified facilities would be extended for three years, from January 1, 2009, to January 1, 2012. However, the placed in service deadline for solar facilities (January 1, 2006) and refined coal and Indian coal production facilities (January 1, 2009) would not be extended.

Limitation of Credit Amount

The phase out of the credit would be eliminated and replaced with a limitation of the credit based on the investment in a facility essentially equal to 35 percent of the capital costs of the facility. This limitation would be effective only for facilities placed in service after December 31, 2009. Under the limitation, the Section 45 tax credits with respect to a facility for any taxable year may not exceed the eligible basis of the facility multiplied by an "applicable percentage" for the month the facility is placed in service. If a facility's production is more or less than the limitation amount, excess amounts may be carried forward, but not beyond the facility's 10-year credit period.

A taxpayer may make an election to treat all qualified facilities that are part of the same project and placed in service in the same calendar year as one facility that is placed in service at the mid-point of the calendar year, or the first day of the following calendar year.

The applicable percentage will be determined by the Secretary of Treasury and will be a percentage "which [yields] over a 10-year period amounts of limitation…which [has] a present value equal to 35 percent of the eligible basis of the facility." The present value will be determined as of the last day of the first year of the 10-year credit period and will use a discount rate equal to the greater of (i) 4.5 percent or (ii) 110 percent of the Federal long-term rate under section 1274(d) for the month preceding the month for which the percentage is determined.

The "eligible basis" of the facility is the basis of the facility determined at the time the facility is placed in service and the portion of the basis of any "shared qualified property which is properly allocable to such facility." Shared qualified property is property which qualifies for 5-year MACRS under section 168(e)(3)(B)(vi) which (i) a qualified facility will require for utilization of such facility, and (ii) is not a "qualified facility." For example, certain material handling equipment used in connection with an open-loop biomass facility that would not be part of the "qualified facility" under IRS Notice 2006-88 and which qualifies for 5-year MACRS would be included in the eligible basis of the facility for purposes of the credit limitation calculation. In addition, the bill provides that the eligible basis of a geothermal facility includes intangible drilling and development costs described in section 263(c) even though such costs are expensed.

Modifications to Trash Combustion and Open- and Closed-Loop Facility Definitions

The House Bill would also amend the definition of a trash combustion facility to clarify that, in order to qualify for the section 45 tax credit, the municipal solid waste (trash) does not need to be burned directly in the facility and that the trash can be gasified first and the gas can then be used to generate electricity. The House Bill would also provide that a new unit placed in service in connection with an open-loop biomass facility or a closed-loop biomass facility would qualify for the tax credits to the extent of the increased amount of electricity produced at the facility by reason of such unit. However, the provision does not define what equipment would constitute a "new unit."

Addition of Marine Renewables

Marine and hydrokinetic renewable energy would be added to the list of "qualified energy resources." Marine and hydrokinetic renewable energy is defined as energy derived from (1) waves, tides, and currents in oceans, estuaries, and tidal areas; (2) free flowing water in rivers, lakes, and streams; (3) free flowing water in an irrigation system, canal, or other man-made channel (including projects that use non-mechanical structures to accelerate the flow of water for electric power production purposes); or (4) differentials in ocean temperature. The term excludes energy derived from any source that uses a dam, diversionary structure (except for irrigation systems, canals, and other man-made channels), or impoundment for electric power production.

A marine and hydrokinetic renewable energy facility would include any such facility placed in service after the date of enactment and before January 1, 2012 and that has a nameplate capacity rating of at least 150 kilowatts. The credit amount for such facilities would be one-half of the full credit amount. Note that the definition of marine and hydrokinetic renewable energy facilities would include small irrigation facilities. Accordingly, such facilities placed in service on or after the date of enactment would qualify for the credit as marine and hydrokinetic renewable energy facilities.

Section 48 Provisions

The House Bill would extend the 30 percent ITC for solar and fuel cell property for eight years (from January 1, 2009 to January 1, 2017). The bill would also increase the tax credit limitation of $500 per 0.5 kilowatt of capacity for qualified fuel cell property to $1,500. The provision excluding public utility property from the definition of "energy property" would be eliminated and the Section 48 tax credit would be allowed against the alternative minimum tax. The House Bill did not contain an expansion of the 30 percent ITC to include combined heat and power system property as was contained in the prior energy tax bill passed by the House.

Clean Renewable Energy Bonds and Other Tax Credit Bonds

The House Bill would create a new category of clean renewable energy bonds ("New CREBs") to finance qualified renewable energy facilities that (a) qualify under Section 45 (other than refined coal or Indian coal facilities and without regard to placed-in-service dates), and (b) are owned by public power providers ("PPPs") or cooperative electric companies ("CECs"). Interestingly, the House Bill excludes facilities owned by governmental bodies. The bond limitation for the New CREBs would be $2 billion, of which not more than 60 percent of the total would be allocated to PPPs, and not more than 40 percent would be allocated to CECs. Allocations to PPP projects would be made *pro rata* to each project compared to the total amount requested. As an example, if $1.5 billion is requested in allocation of New CREBs for PPP projects, each PPP project would receive 80 percent of its requested allocation. On the other hand, allocations of CEC projects would be made in a manner determined by Treasury.

Under the New CREBs program, 100 percent of the proceeds of New CREBs (less issuance costs of no more than 2 percent of the bond) and any investment earnings on such proceeds would be required to be used on capital expenditures for the project within three years of the date of issuance (with limited exceptions). The House Bill also would provide that the tax credit rate for New CREBs is a rate that is 70 percent of the rate that would permit issuance of a New CREB without discount and interest cost to the issuer; the credit would be claimed against both regular and AMT tax liability; any unused credit could be carried forward; and credits could be "stripped" from the ownership of the bond, similar to the "stripping" of interest coupons for tax-exempt bonds. Interestingly, under the House Bill, a New CREB would also require the issuer to certify that applicable conflicts of interests laws are satisfied in regard to the New CREB issuance. In addition, the House Bill would provide that certain labor standards would apply to projects financed with New CREBs or the new tax credit bond program described below.

The House Bill would also create a new tax credit bond program for "qualified energy conservation bonds" ("QECBs"). The rules for QECBs are similar to those for New CREBs.

Set forth below are the significant highlights of the QECB program under House Bill.

- QECB Purposes - projects related to reducing energy consumption in public buildings by at least 20 percent; implementing green community programs; rural development involving renewable energy production; qualified facilities as determined under Section 45(d) (other than refined coal or Indian coal facilities and without regard to placed-in-service dates) (i.e., the same projects that qualify under the New CREBs); certain research facilities generally involving increasing energy efficiency and reducing fossil fuel consumption; commuting facilities that reduce energy consumption (and pollution); certain demonstration projects; and energy efficiency public education campaigns.

- QECB Allocation - $3.6 billion to be distributed among the states and further subdivided among large local governments (i.e. population of 100,000 or more), all proportionately based on population. Indian tribal governments are to be treated in the same manner as large local governments.

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