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# RENEWABLE ENERGY TAX CREDITS AND GRANTS

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## RENEWABLE ENERGY TAX CREDITS AND GRANTS

### Introduction

Business taxpayers who place in service facilities that produce electricity from certain renewable resources<sup>1</sup> (“**Qualified Facilities**”) can choose one of three new incentives to financially assist the project: a tax credit based on the amount invested, a tax credit based on the energy produced or a grant.

The flexibility to choose among these incentives was enacted as part of the American Recovery and Reinvestment Act (“**ARRA**”). Prior to the ARRA, Qualified Facilities were only eligible for the tax credit based on energy produced under Section 45 of the Internal Revenue Code of 1986, as amended (the “**Code**”). Unlike many provisions of the ARRA, the ability to choose among these incentives does not expire at the end of 2010, but is subject to timing requirements as described below.

Taxpayers may opt to claim the energy investment tax credit, which generally provides a 30 percent tax credit for investments in energy projects,<sup>2</sup> instead of the production tax credit, which, for 2010, can provide a credit of up to 2.2¢/kWh for wind, geothermal, closed-loop biomass and solar energy; 1.1¢/kWh for other eligible technologies.

Taxpayers making qualified investments that are placed in service after 2008 and before 2014 (or 2013 for wind facilities) can make an irrevocable election to claim the energy investment tax credit instead of the renewable electricity production tax credit.

A key benefit of the investment tax credit provided by the ARRA is the elimination of the reduction of that tax credit for “**subsidized energy financing**”<sup>3</sup> and tax-exempt bonds used to finance a project. The reduction for subsidized energy financing and tax-exempt bond financing remains a component of the production tax credit, and thus should be considered when choosing between the production tax credit, the investment tax credit or the federal grant.

Taxpayers also can claim a grant from the United States Department of Treasury once the property is placed in service instead of claiming either the energy investment tax credit or the renewable energy production tax credit. Applications for this grant must be made by October 1, 2012. For qualified renewable energy facilities, the grant is 30 percent of the investment in the facility as long as construction begins in 2009, 2010 or 2011 and the property is placed in service before 2014 (2013 for wind facilities). Construction is generally considered to begin when

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<sup>1</sup> That is wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, marine and hydrokinetic renewable energy

<sup>2</sup> Prior to the ARRA, the investment tax credit was limited to geothermal property, qualified fuel cell property or stationary microturbine property, combined heat and power system property, qualified small wind energy property, and geothermal heat pump systems.

<sup>3</sup> The term “subsidized energy financing” means financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

“physical work of a significant nature begins.” The United States Department of Treasury has issued a “1603 Begun Construction Checklist”, a copy of which is attached hereto as Exhibit A. Work performed by the taxpayer and by other persons under a written binding contract is taken into account in determining whether construction has begun. Both on-site and off-site work may be taken into account for purposes of demonstrating that physical work of a significant nature has begun. A safe harbor is provided allowing taxpayers to treat physical work of a significant nature as beginning when the taxpayer incurs or pays more than 5 percent of the total cost of the property (excluding the cost of any land and certain preliminary activities such as site clearing). In the case of property manufactured, constructed, or produced for the taxpayer by another person under a binding written contract that is entered into prior to the manufacture, construction, or production of the property (i) the cost of the property under the contract is treated as paid or incurred when the property is provided to the taxpayer, and (ii) for periods before the property is provided to the taxpayer, costs paid or incurred with respect to the property by such other person are treated as costs of the property that are paid or incurred when paid or incurred by such other person. Merely entering into a contract without paying or incurring project costs will not satisfy the safe harbor.

Taxpayers electing to receive the grant will not be eligible for either of the tax credits. Proceeds from the grants are not includible in the taxpayer's gross income, but the grant amount is subject to recapture if the property is disposed of to a disqualified person<sup>4</sup> or otherwise ceases to qualify as a Qualified Facility. For recapture purposes, the grant vests ratably over five years.

Surplus production tax credit or investment tax credits cannot be sold directly to another party. However, in the case of multiple owners, tax credits are shared based on the ownership interests. The most common method to provide for multiple owners of a facility is the use of an entity treated as a partnership for federal income tax purposes, *e.g.*, a limited partnership or a limited liability company. For tax purposes such partnerships are not subject to tax; instead, each partner is treated as an owner of a proportional share of each of the partnership's underlying assets. Consequently each partner will be eligible for a share of the tax credits. By using such a partnership the surplus tax credits (up to 99% of all credits generated) may be transferred to a tax credit investor.

This field is highly technical. The discussion above is qualified entirely by reference to the ARRA and the regulations thereunder.

### **More Information**

This paper is a quick-reference guide for company executives and managers, economic developers, participants in the real estate and financial industries, and their advisors. The information in this paper is general in nature. Various points which could be important in a particular case have been condensed or omitted in the interest of readability. This paper does not express any opinions on legal or tax matters. Specific professional advice should be obtained

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<sup>4</sup> Any federal, state, local or tribal government entity, tax-exempt entity, cooperative electric company, clean renewable energy bond lender, or any partnership or other pass-through entity of which one of the above entities is a direct or indirect partner.

before this information is applied to any particular case. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

Additional information concerning this topic, as well as White Papers and references on other topics, can be found at <http://danmcrae.info/>.

If you have any specific questions or comments, we would be pleased to provide more information. Please contact:

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## Exhibit A

### Treasury 1603: Begun Construction Applicant Checklist

Thank you for registering with Section 1603. Please take time to print and fill out this checklist prior to submitting your application. This checklist is designed to assist you in submitting a complete application. While this checklist does not address all possible scenarios for a complete application, most applicants should find that completing this checklist will make the review process more efficient and expedite determination. This checklist is for the documents being uploaded in Section 6A of the application.

#### **For Applicants Electing 5% Safe Harbor** – *All applicants* must document the costs paid/incurred.

Required documentation includes:

- A statement from an authorized representative of the applicant signed under penalties of perjury attesting to the method of accounting by the applicant for federal tax purposes and the amount paid (for cash method applicants) or incurred (for accrual method applicants) before the end of 2010;
- Evidence of the costs paid/incurred such as invoices or other financial records;
- Detailed description of the costs paid/incurred including delineation of eligible and ineligible costs;
- For projects with an estimated cost basis of \$1 million or more, an independent accountant's report that includes all of the above information. Applicants should go here to view the requirements for the independent accountant's report.

#### *Applicants Reliant on Costs Paid or Incurred by a Contractor Must Also Submit*

- A copy of the binding written contract;
- Statement from the contractor, signed under penalty of perjury, of costs paid/incurred and allocated to applicant's project;
- Evidence of the costs paid/incurred by the contractor such as invoices or other financial records.

#### **For Applicants Electing "Physical Work of a Significant Nature"** – *All applicants* must document the physical work. Required documentation includes:

- A written report from the project engineer or installer signed under penalties of perjury describing the project's eligibility and the work that has commenced;
- Detailed construction schedule;
- Evidence that eligible work has commenced including invoices for work performed;
- Photographs of the physical work (optional, but may be helpful in the review process).
- For projects with an estimated cost basis of \$1 million or more, a written report from an independent engineer describing the project's eligibility and the work that has commenced.

#### *Applicants Relying on Physical Work Commencing Under a Contract Must Also Submit*

- A copy of the binding written contract;
- Statement from the contractor, signed under penalty of perjury, describing the work that has commenced and certifying that the work commenced pursuant to the binding written contract and is on eligible property for the applicant's project. This must include a detailed description of both the nature of the work in total, as well as what work has taken place.

This checklist is for applicant use only and does not address all possible scenarios for a complete application. Please do not upload the checklist. Ultimately, IRS rules and Treasury 1603 requirements apply. See Program Guidance here: <http://www.ustreas.gov/recovery/docs/guidance.pdf>.