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Tax Incentives for Renewables Investments

Where the Market is Heading in the Post-Cash Grant Era

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Since the American Recovery and Reinvestment Act of 2009, many US renewable energy projects have relied on the Treasury cash grant program to help underpin their financing structures. The cash grant program provides reimbursement for 30% of eligible costs incurred to install technologies such as wind, solar, biomass, and hydrogen fuel cells. The cash grant is available only for projects that began construction prior to the end of 2011, and further extension of the program by Congress is uncertain at best. In addition, the production tax credit (PTC) for wind energy projects is slated to expire at the end of 2012.

Despite the slated wind down of the Treasury cash grant program and the uncertainty in the wind markets, there has been significant activity among investors in several types of renewables projects. However, each requires both operational and compliance planning.

Grandfathered Cash Grant Projects

Many developers took steps at the end of 2011 to meet the "begun construction" safe harbor for renewables projects. Where successfully achieved, the safe harbor allows the project to qualify for the Treasury cash grant as long as it is completed prior to the expiration date for the underlying tax credit. Many developers with grandfathered projects need financing to complete them and are actively seeking investors. Potential investors need to conduct a thorough due diligence on these opportunities, not only for standard operational and financial issues but also to check that the project successfully meets the safe harbor standard and will be completed in time to qualify for the cash grant program.

When do major federal energy tax credits expire?

Wind	December 31, 2012
Solar	December 31, 2016
Biomass	December 31, 2013
Biofuels	December 31, 2011
Cellulosic biofuels	December 31, 2012
Fuel cells	December 31, 2016

Solar Projects

New development in 2012 has focused largely on solar projects. The long remaining window for investment tax credits (ITCs) and sharp drops in equipment prices make solar projects increasingly attractive and perhaps near grid-parity in more expensive electricity markets. In addition, a recent IRS private letter ruling concludes that the value of a power purchase agreement that is inextricably linked to a particular wind energy facility need not be separately valued for depreciation purposes. If similar principles can be applied to other technologies and also to the ITC or cash grant, the result may be favorable for investors.

Biomass Projects

Numerous companies are working to get biomass projects underway to have them placed in service prior to the December 31, 2013 deadline. It should be noted that the eligibility rules under the cash grant program are somewhat more generous than for the underlying PTC; in particular, cash grant applicants typically can include some or all of their biomass handling equipment in eligible basis.

Return of Tax Equity Structures

For projects begun in 2012, tax "appetite" for both depreciation deductions and tax credits is back at the forefront of financing issues. Many developers resolve this challenge by bringing in a "tax equity" investor as a partner or through a leasing transaction. When properly implemented, a tax equity structure allows efficient current monetization of these benefits. Although tax equity investing traditionally has been driven by financial institutions, many non-banks have started to evaluate investment opportunities that can yield tax benefits while making progress on their sustainability agendas.

Compliance Issues

Recent trends in the Treasury cash grant program suggest that companies should be prepared for increased scrutiny of their grant applications and perhaps also for tax credit claims. IRS guidance issued last fall describes procedures for overpayments of cash grants, signalling that the IRS apparently will exercise its authority to audit the exclusion of cash grant amounts from income and expect inclusion in income and/or repayment where it concludes that Treasury overpaid grant applicants. Accordingly, companies should plan to devote attention not only to getting their applications through the Treasury review process but also to post-award recordkeeping and compliance.

Even as the Treasury cash grant program winds down, there are significant opportunities for renewable energy investors. Successful investments must be planned with careful attention to tax -- not only to ensure efficient use of PTCs or ITCs but also to place projects into service before applicable statutory deadlines.

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