

Taking advantage of tax incentives for cleantech companies

Insights for technology companies October 2010

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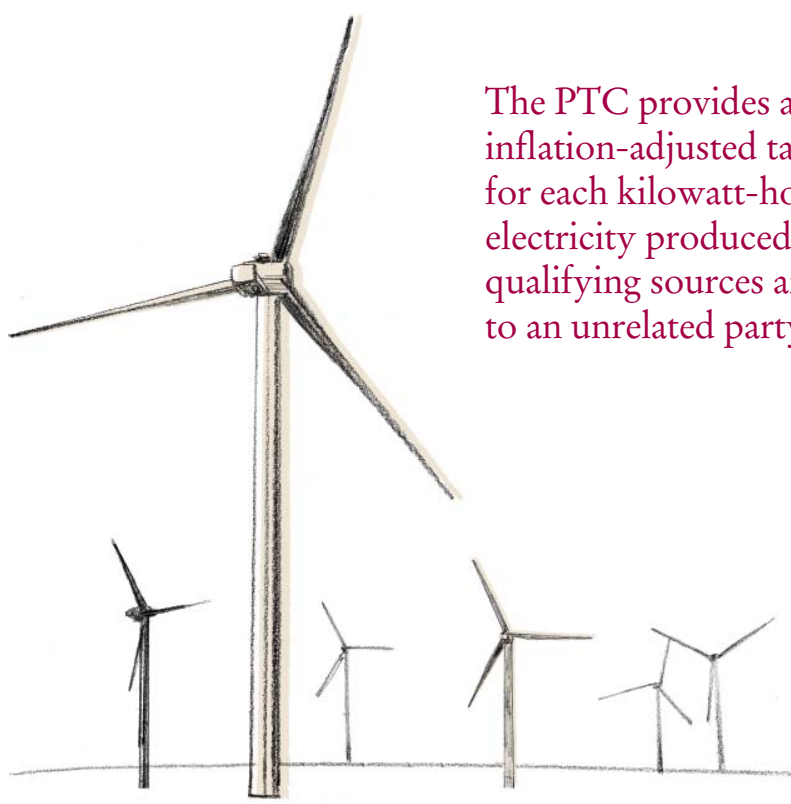
The cleantech sector is poised for growth in the coming months and years thanks to both recent legislation and an ongoing commitment to the industry from the federal government. The most significant investment was made in 2009 with the American Recovery and Reinvestment

Act (ARRA), which injected into the economy roughly \$60 billion in green initiatives and \$20 billion in beneficial tax incentives for cleantech companies. In addition to direct grants and loan guarantees, the cleantech programs feature substantial tax incentives. Here's what cleantech companies need to know about the available tax incentives and how their companies may benefit.

Extension of production tax credits

Companies that need large amounts of capital for renewable energy projects will benefit from ARRA's extension of the renewable electricity production tax credit (PTC) under Section 45 of the Internal Revenue Code (IRC). Wind facilities can now be placed in service until Dec. 31, 2012 and qualify. All other qualifying renewable facilities have until Dec. 31, 2013. This credit has existed since 1992, but has often been extended only in one- or two-year intervals. Cleantech companies now have more flexibility and certainty in their planning.

The PTC provides an inflation-adjusted tax credit for each kilowatt-hour of electricity produced from qualifying sources and sold to an unrelated party. The credit amount in 2010 is 2.2 cents per kilowatt-hour for wind, closed-loop biomass, geothermal and solar sources. The credit is 1.1 cents per kilowatt-hour for open-loop biomass, small irrigation power, landfill gas, trash combustion, qualified hydropower, and marine and hydrokinetic sources. It is generally available for 10 years after qualifying property is placed in service in the case of wind, closed-loop biomass, solar and certain hydro-based sources; and for five years for other types of qualifying power production. But this can be reduced by up to half if companies also are receiving government grants, tax-exempt bonds or other credits.



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Energy tax credits/investment tax credits

More importantly, ARRA created an election to allow taxpayers to use the IRC Section 48 energy tax credit (ETC) in place of the PTC. The ETC provides a 30 percent or 10 percent credit for investments in qualifying energy property. PTC property will qualify for the full 30 percent credit, giving cleantech businesses a valuable option to consider.

ARRA and the Emergency Economic Stabilization Act of 2008 also made a number of other important changes to the ETC. The types of energy properties eligible for the ETC now include microturbine (30% credit), combined heat and power — or cogeneration — systems (10% credit), and geothermal heat pumps (10% credit). The placed-in-service deadline for solar, qualified fuel cell and microturbine property has also been extended to Dec. 31, 2016.

The ETC may now be used against the alternative minimum tax. ARRA also raised the limitation for qualified fuel cells from \$500 to \$1,500 per half kilowatt of capacity. Public utility properties are no longer excluded from the ETC. In addition, effective Jan. 1, 2009, the ETC can be claimed without regard to whether the facility is financed with subsidized energy financing or industrial development bonds.

Grants in lieu of tax credits

A third valuable option provided by ARRA is a new provision allowing taxpayers to apply for grants in lieu of the PTC or ETC. The grant amount is 30 percent of the tax basis of eligible solar, qualified fuel cell and wind property and 10 percent for other ETC property systems. The grants are generally available for property placed in service in 2009 or 2010 (or if construction begins in those years and is completed prior to the grant termination date).

All applicable ETC dollar limitations also apply to grants, such as \$1,500 per half kilowatt of capacity of qualified fuel cell. The grants are to be made within 60 days of the later of application or the date the property is placed in service. Applications must be made on or before Sept. 30, 2011. Grant proceeds are not considered as gross income. Other normal ETC progress expenditure and recapture rules still apply.

It's important to remember that tax-exempt organizations, including federal, state or local government units, municipalities and 501(c) organizations, are not eligible to receive grants. Organizations with a partner — no matter how small the partnership — that falls into one of those tainted categories cannot get a grant. Under the ETC, properties would not lose the credit if they have tax-exempt investors.

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Determining which tax incentive is best

Determining whether to claim the PTC, elect the ETC or apply for a cash grant is not a straightforward decision. The three options are mutually exclusive, and an election is not expected to be revocable once it has been made.

Each of the options has potential benefits and drawbacks, so a careful consideration of the details and financing options should be undertaken before deciding on an approach.



The availability of the ETC in place of the PTC could accelerate the tax benefits and allow them to be used by an outside nonoperating investor. The ETC also provides much more certainty. Determining the benefits of the PTC is much more complicated, because it requires factoring in installed cost, production capacity and utilization. However, a company has to be the first user of a renewable energy property to claim the ETC; future owners will not benefit from this credit. A future owner of a PTC facility can inherit the PTC credit if the 10-year span of the credit has not been used up.

The cash grant option may be even more appealing to many companies. It makes the tax benefits available without regard to the existing tax status of the taxpayer and eliminates the need for tax-motivated investors.

Each incentive has its benefits for certain types of companies in certain situations; therefore companies should run the numbers before making any decisions. •

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