



New Tax Legislation Promotes Renewable Energy Initiatives

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President Obama pledged strong support for renewable and clean energy initiatives, both during his campaign and after the election. The American Recovery and Reinvestment Act of 2009 (ARRA), enacted earlier this year, was an important first step in delivering on some campaign promises. It contains several provisions that give tax incentives to both individuals and businesses taking steps to become more energy efficient. It has also helped bolster a new fledgling industry centered around “green” construction and renewable energy resources which should help create new jobs.

Newport County is seeing its share of renewable energy projects. Portsmouth Abbey led the way in 2006 with the installation of a 660kW wind turbine generator, the first of its kind in Rhode Island. The Town of Portsmouth followed in March 2009, with their own 1.5MW wind turbine that is expected to generate more than 60% of the towns electricity needs for its municipal buildings, including schools. Another turbine was erected in September 2009 in the Aquidneck Corporate Park by Sustainable Global Energy, LLC, a renewable energy resource company that specializes in wind turbine studies and installation. Solar panels are being installed in local businesses and in residences. Many more businesses and non-profit organizations are exploring the feasibility of these projects for themselves.

Businesses have been slow to embrace this new technology because the initial investment can be staggering and the return on investment lengthy. New federal tax incentives and state energy grants are making these projects more affordable by lowering the up-front cost with tax credits, grants and accelerated 50% bonus depreciation write-offs. The project can pay for itself with energy cost savings over a much less number of years.

There are two major sections within the Internal Revenue Code that relate to credits for renewable energy production and renewable energy property acquisitions. IRC §45 relates to the production of electricity from qualified energy resources such as wind, solar, and geothermal energy, among others. The allowable tax credit is equal to the product of 1.5 cents multiplied by the kilowatt hours produced by the taxpayer at the qualified facility and sold to an unrelated party. The credit is allowed for a 10-year period beginning on the date the facility is placed in service. Prior to ARRA, wind facilities had to be placed in service before 2010, solar energy facilities before 2006, and other qualified facilities before 2011. ARRA extends the placed-in-service requirement for wind facilities through 2012 and other qualified facilities through 2013. Solar energy facilities service date requirement remained at 2006. One of the key items in this section is that only the electricity sold to unrelated parties is eligible for the credit. This restriction limits the number of businesses that can take this credit since many businesses are considering these types of facilities for their own energy cost savings.

For those businesses that are not eligible for the production credit, the energy credit under IRC §48 may be an alternate option. This section allows a 30% business energy credit based on the cost of qualified property, including installation. Prior to ARRA, the credit was capped at \$4,000. The Act eliminated the cap. Qualifying property includes fuel cell property, solar property, small wind energy property and geothermal heat pump property. A 10% credit is allowed for geothermal power production property, combined heat and power system property and micro turbine property.

Small wind energy property is defined as a wind turbine which has a nameplate capacity of not more than 100 kilowatts. Compare that with the turbines erected at Portsmouth Abbey at 660kW and by the Town of Portsmouth, at 1.5MW. Most wind turbines being considered today have a greater nameplate capacity than 100kW. This restriction would appear to eliminate many projects from being eligible for this credit. However, ARRA added a provision that allows taxpayers to make an election to treat qualified energy production property under §45 as energy property under §48. This election would allow the 30% credit on the larger wind turbines, assuming all other criteria are met, including placed-in-service dates. If the election is made, no credit under §45 is allowed.

ARRA also authorized the Secretary of Energy to issue grants to taxpayers placing qualified property under either the electricity production credit or under the energy property credit in service during 2009 and 2010. The grant is equal to 30% of the cost of the qualifying property and shall be paid to the taxpayer within a 60 day period which begins upon the later of the date of the application or the placed in service date. The grant is received by the taxpayer in lieu of taking a credit under §45 or §48. The basis of the qualifying property is reduced by 50% of the grant for depreciation purposes. Any sale or other disposition of the property within a 5-year period from the placed-in-service date will cause part or all of the grant to be recaptured into the income of the taxpayer. Nonprofit organizations and municipalities are not eligible for these grants.

With the extension and expansion of energy provisions already in existence and the creation of the Secretary of Energy grants, business owners are taking a more serious look at initiating a renewable energy resource program. The after tax costs look more affordable than ever. Consider the following example.

Business purchases qualified energy property at an initial cost of \$1M. A grant of 30% is received within 60 days of placing the property in service. The net cost after the grant is \$700,000. For depreciation purposes, the basis of the property is \$850,000. With the 50% bonus depreciation in effect during 2009, the business will receive a deduction of \$510,000 (50% + 20% of the remaining 50%) in the first year. Assuming a federal tax rate of 35%, the tax savings on this deduction would be \$178,500. In year one, business has recouped \$478,500 of its initial \$1M investment, and this does not even take into account the money saved on energy costs or any potential state grants that may be available.

Businesses considering initiating their own renewable energy resource program should consult with their tax advisors early in the process. There are many things to consider prior to finalizing the plans. What are the cash flow projections for the project? How should the purchase be financed? Should the facility be in a separate business entity, like an LLC or LLP? Should a grant be applied for or would the tax credits be more beneficial? The answers to these questions depend on each business's specific circumstances. Your tax advisor will be instrumental in helping you determine the best course of action and ensuring you are taking full advantage of all the incentives available. Keep in mind many of these provisions have expiration dates, so if you have been thinking about "going green", there has never been a better time to do it!