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UPDATE

May 2008

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Ways & Means Committee Passes Extenders Bill

On May 15, 2008, the House Ways and Means Committee passed the "Energy and Tax Extenders Act of 2008" (H.R. 6049) (the "Bill") by a vote of 25 to 12. The Bill includes $16.9 billion in energy tax incentives and is fully offset by certain tax changes. The Bill is expected to be considered by the full House of Representatives as early as this week (week of May 19). A copy of the Bill is available here and a copy of the Joint Committee on Taxation explanation is available here. The Senate Finance Committee is expected to mark up its version of the extenders bill (S. 2886) after the Memorial Day recess. The energy tax credit provisions contained in the Senate version of an extenders bill were described in a prior email alert.

Section 45

Extension

The Bill would extend for three years the placed-in-service deadline (through the end of 2011) for facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste and qualified hydropower. However, the Bill would extend for only one year the placed-in-service deadline for wind facilities. Extensions were not provided for solar, refined coal and Indian coal facilities.

Marine/Hydrokinetic

The Bill also adds marine and hydrokinetic renewable energy as a qualified resource under Section 45. The Bill defines marine and hydrokinetic renewable energy 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 nonmechanical structures to accelerate the flow of water for electric power production purposes); or (4) differentials in ocean temperature (ocean thermal energy conversion). 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 that produces electric power from marine and hydrokinetic renewable energy 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 subsumes small irrigation facilities and, consequently, the Bill terminates these facilities as a separate category.

Phaseout Repeal/Investment-Based Limitation

The Bill repeals the current phaseout for facilities placed in service after 2008. The Bill replaces the phaseout with an *investment-based limitation* for facilities placed in service after 2009. This limitation is based on an "applicable percentage," which is defined for any month as the percentage that yields over a 10-year period amounts of limitation that have a present value equal to 35 percent of the

eligible basis of the facility. For purposes of the calculation, the discount rate is the greater of 4.5 percent or 110 percent of the long-term federal rate.

The eligible basis of a facility is generally its basis at the time it is originally placed in service. However, special rules apply for determining the eligible basis of shared property at a project (e.g., allocation of shared property at a wind farm among separate wind facilities). Under the special rule, the basis of the "shared qualified property" is allocated in proportion to the projected generation from the qualified facilities. Also, in the case of a qualified geothermal facility, the eligible basis includes intangible drilling and development costs.

The Bill would provide a special election to treat all qualified facilities that are part of the same project and that are placed in service during the same calendar year as a single facility placed in service at either the midpoint of such year or the first day of the following calendar year.

Special rules would also be provided for calculating the credit for the first and last years of the 10-year credit period and for carrying forward any unused limitation and excess credit.

Qualified Hydropower Production

The Bill would modify the definition of a nonhydroelectric dam for purposes of qualified hydropower production by (i) requiring it to be operated for flood control, navigation or water-supply purposes and (ii) replacing the requirement that the project not enlarge the diversion structure or bypass channel, or impound additional water from the natural stream channel, with a requirement that the project be operated so that the water surface elevation at any given location and time be the same as would occur in the absence of the project.

Other Section 45 Provisions

The Bill would modify the definition of qualified trash combustion facilities to cover facilities that gasify municipal solid waste and then burn the gas to generate electricity. The Bill would also allow expansions of existing open-loop and closed-loop biomass facilities to qualify for the Section 45 credit to the extent of the increased amount of electricity produced at such facilities by reason of the addition of the new unit. Finally, the Bill would modify the unrelated person rule to clarify that sales of electricity by a partnership to a regulated public utility partner would not fail the unrelated person rule and such sales would qualify for the credit.

Section 48

The Bill would extend for six years the placed-in-service deadline (through 2014) for solar energy, fuel cell and microturbine property. The Bill would also permit the energy credit determined under Section 48 to be used as a credit against the alternative minimum tax, effective for credits determined in taxable years beginning after the date of enactment. The Bill would repeal the public utility exception applicable to energy property owned by public utilities for periods after February 13, 2008, in taxable years ending after such date. Finally, the Bill would raise the $500 per half kilowatt of capacity credit cap for fuel cell property to a $1,500 per half kilowatt of capacity credit cap, effective as of the date of enactment.

Combined Heat and Power Property

The Bill would add a new category of energy property to Section 48 for combined heat and power property ("CHP property"). CHP property is defined as property comprising a system: (A) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (B) that produces (i) at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power and (ii) produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); (C) has an energy efficiency percentage (as defined in the Bill) that exceeds 60 percent; and (D) that is placed in service before January 1, 2015. CHP property would be eligible for the 10 percent energy credit under Section 48, subject to various limitations based on electrical or mechanical capacity.

Clean Renewable Energy Bonds

The 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"), governmental bodies or cooperative electric companies ("CECs"). A PPP is a state utility with a service obligation, as such terms are defined in Section 217 of the Federal Power Act.

The bond limitation for the New CREBs would be $2 billion, of which no more than one-third may be allocated to projects of PPPs, governmental bodies or CECs. Allocations to projects of PPPs would be made in such a manner that the amount allocated to each such project bears the same ratio to the cost of such project as the maximum allocation limitation to projects of PPPs bears to the cost of all such projects.

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 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 Bill, a New CREB would also require the issuer to certify that applicable financial conflicts of interests laws are satisfied concerning the New CREB issuance. In addition, the 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 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 the Bill.

- QECB Purposes — projects related to reducing energy consumption in publicly owned 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 billion to be distributed among the states and further subdivided among large local governments (i.e., with populations 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.

Section 48A/48B

The Bill would increase the Section 48A credit for IGCC and other advanced coal projects from the current credit rate of 20 percent to 30 percent and permit the allocation of an additional $1.25 billion in credits to qualifying projects. The Bill would also increase the Section 48B credit for qualifying gasification projects from the current credit rate of 20 percent to 30 percent and permit the allocation of an additional $250 million in credits to qualifying projects. The allocation would be effective on the date of enactment and the increase in the credit rate would be effective for the additional allocations.

The Bill would require (a) qualifying Section 48A projects to include equipment that separates and sequesters at least 65 percent of the project's total carbon dioxide (70 percent in the case of a reallocation) and (b) qualifying Section 48B projects to include equipment that separates and sequesters at least 75 percent of total carbon dioxide emissions. The Bill would provide for recapture of the credit if a project fails to attain or maintain these required levels of sequestration. In selecting qualifying projects, the Bill would require the secretary to give the highest priority to projects with the greatest separation and sequestration and high priority to applicants that have a research partnership with an eligible educational institution.

The Bill would also require public disclosure of projects receiving credit allocations, including the identity of the taxpayer and the amount of the credit awarded. The Bill also prescribes certain requirements for modifying competitive certification awards and closing agreements about Section 48A projects.

Excelsior Energy Receives Second Round Section 48A Tax Credit Allocation

On May 7, 2008, Excelsior Energy announced that it received an allocation of $133.5 million in Section 48A tax credits for its Mesaba project. A copy of the press release is available here. To date, none of the Treasury, the IRS or the Department of Energy has announced the results of the second round of allocations.

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