



# Tax Credit Alert

## Recent developments in tax credits

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## Renewable energy tax provisions in the American Recovery and Reinvestment Act of 2009

*By Forrest David Milder*

This *Tax Credit Alert* describes the provisions of the American Recovery and Reinvestment Act of 2009 (2009 Act) that relate to the Section 45 Production Tax Credit (PTC) and the Section 48 Energy Tax Credit (Energy Tax Credit), as well as a new program that allows project owners to get grants from the federal government, rather than offer the credits to investors, and several other new provisions of interest. Those who read our January 27 snapshot of the bill that ultimately became the 2009 Act will recognize most of these newly enacted provisions.

***Extension of the Production Tax Credit.*** The 2009 Act provides a full, three-year extension for many PTC-eligible facilities. Wind projects will now qualify for the credit if they are placed in service by December 31, 2012, and biomass, geothermal, landfill gas, and trash will now qualify for the credit if they are placed in service by December 31, 2013. Finally, the placed-in-service date for qualified hydropower and marine and hydrokinetic facilities was extended by two years, also to December 31, 2013.

***Claiming the Energy Tax Credit for a PTC facility.*** The 2009 Act adds a new subsection to Section 48 allowing a wide range of PTC-eligible facilities to claim the 30-percent Energy Tax Credit, rather than the production tax credit. These include wind, biomass, geothermal, landfill gas, trash, qualified hydropower, and marine and hydrokinetic facilities placed in service from 2009 through 2012 (for wind) and through 2013 (for the other power sources). Projects making the election are no longer eligible for the PTC. The Act does not provide any guidance as to how or when the election is made, although the Conference Report indicates that only property eligible for five-year depreciation can qualify under this rule. Obviously, this is a **big** change in particular, if these PTC facilities make the election, then they no longer need to sell electricity in order to generate the credit, and the entire 30 percent is obtained at once, rather than over 10 years.

***Converting the Energy Tax Credit to a Grant.*** Facilities eligible for the energy tax credit can instead claim a dollar-for-dollar grant from the US Treasury. Eligible facilities include both those that have always been eligible for energy credits in particular, solar and fuel cell projects, as well as the new PTC-eligible facilities that elect Section 48 treatment. Most facilities are eligible for a 30-percent grant, but some (geothermal, qualified microturbine, combined heat and power, and geothermal heat pump) qualify only for a smaller, 10-percent grant.

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The Act provides some strict timetables with respect to grants. First, construction of the project must begin in 2009 or 2010; second, the Treasury must pay the amount of the grant within 60 days of the placed-in-service date or the date of the application, if later; third, the project must be placed in service by the PTC or Energy Credit deadline that otherwise applies to the particular facility. And there are technical rules as well: the grant is not income, and expenditures made with the grant are included in basis and eligible for depreciation, but reduced by half the amount of the grant (i.e., like the adjustment that applies to the credit; effectively, 85 percent of costs paid with a grant will be eligible for depreciation). Treasury is authorized to provide repayment rules which would presumably be similar to the five-year, 20-percent per year recapture rule that generally applies to investment tax credits. Federal, state, or local governments or tax-exempt entities (including partnerships or LLCs which have these entities as partners or members) cannot claim grants.

***Subsidized energy financing.*** The 2009 Act repeals the rule that reduces the amount of the Section 48 energy credit if a project benefits from below-market financing or tax-exempt debt.

***Bonus depreciation.*** The Act reinstates 50-percent bonus depreciation for property placed in service in 2009. Technical rules based on the date of a binding contract can affect whether a particular property qualifies.

***Bonds.*** The Act increases the authorized amount of Clean Renewable Energy Bonds (CREBs) that benefit state, local, and tribal governments; public power providers; and cooperatives, by \$1.6 billion, and the authorized amount of qualified energy conservation bonds for state, municipal, and tribal government programs, as well as utility programs that provide energy-efficient property to rate-payers, by \$2.4 billion. These and other bond changes will be covered in another NP *Client Alert*.

***Miscellaneous changes.*** For small wind facilities placed in service after December 31, 2008, the \$4,000 cap on the credit is eliminated. The 2009 Act also eliminates the caps on the 30-percent credit for many non-business energy properties, including solar water heaters, small wind facilities, and geothermal heat pumps. (You'll remember that 2008 legislation had already eliminated the cap on solar electric.) The 2009 Act extends the placed-in-service date for many non-business energy efficiency improvements to December 31, 2010; increases the credit rate for those expenditures from 10 percent to 30 percent; and sets a single overall (and lifetime) cap for these expenditures at \$1,500, rather than the several smaller caps for each kind of improvement in effect under prior law. The 2009 Act sets many new rules for alternative fuel vehicles and their refueling and also for electric drive vehicles. Finally, the Act provides a new, 30-percent credit for investment in a qualifying advanced energy manufacturing project that re-equips, expands, or establishes a manufacturing facility for a wide variety of renewable technologies.

As you can see, the changes made by the 2009 Act are extensive, and will lead to major changes in the way that renewable transactions are structured. Furthermore, some of the credit changes described above only apply to the portion of expenditures incurred after 2008. We'd be pleased to assist you in determining and maximizing the incentives that apply to your project and assuring that you meet the effective dates and transition rules where applicable.

Please feel free to contact your regular Nixon Peabody attorneys, or Forrest Milder (617-345-1055, [fmilder@nixonpeabody.com](mailto:fmilder@nixonpeabody.com)), Jim Duffy (617-345-1129, [jduffy@nixonpeabody.com](mailto:jduffy@nixonpeabody.com)), Herb Stevens (202-585-8811, [hstevens@nixonpeabody.com](mailto:hstevens@nixonpeabody.com)), or Michael Goldman (202-585-8289, [mjgoldman@nixonpeabody.com](mailto:mjgoldman@nixonpeabody.com)) with your thoughts and questions. We look forward to hearing from you.

# *The Benefits of Going Green*

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*Learn the Basics:*

*Housing Tax Credit “101”*

*March 6, 2009*

# Housing and Economic Recovery Act of 2008 Impact on Low Income Housing Tax Credits

- Historic character and Energy Efficiency are now part of the selection criteria.
- States amended Qualified Allocation Plans to incorporate criteria.

# PHFA's Energy Efficiency – Green Efforts

- Since 2001 - looked at energy efficiency components
- 2003 - points for exceeding insulation levels by 10%
- 2005 - points for exceeding insulation levels by 10%
  - reducing air infiltration to 0.35 to 0.50 air changes per hour verified by blower door test
  - exclusively using Energy Star appliances and equipment
- 2006 - points for exclusively using Energy Star
  - achieving Home Energy Rating System (HERS) score for Energy Star
  - Meeting Green Building Criteria

# Threshold Criteria

## Energy Conservation – New since 2008

### New Construction & Rehabs

- Energy Star appliances & equipment
- 50% of permanent room lights in apartments must utilize compact fluorescent bulbs
- 100% of community room, corridor & stair lighting must be fluorescent with electronic ballast or use compact fluorescent bulbs
- HERS index necessary for an Energy Star label for new construction – within 2 points for rehabs

# Threshold Criteria Energy Conservation

## Preservation Developments

- Special requirements for replacing existing appliances & equipment with Energy Star type, depending on age
- Community room, corridor & stair lighting more than 15 years old must be replaced with fluorescent fixtures with electronic ballasts or use compact fluorescent bulbs

# Threshold Criteria

## Phase I Report & Testing

- In accordance with ASTM E-1527-05 & Submission Guide for Architects
- Not more than 12 months old
- Existing buildings – include tests results for:
  - Asbestos, Lead in Water, Lead Based Paint & Radon
- Certification stating that any issues raised in the report have been reviewed and budgeted
- Only Executive Summary should be submitted, must include environmental concerns, need for Phase II, test results, and cost estimate for remediation

# 2009 Selection Criteria

Community & Economic Impact	30
Development Characteristics	15
Resident Population & Services	60
Development Process	0
Financial Aspects	<u>30</u>
Total	140

# Development Characteristics

## Energy Conservation – 10 points

Five points if the building envelope U-overall value exceeds 2006 IECC requirements by 10% or more.

Five points if the Green Building Criteria are achieved.

# Green Building Criteria

- Use water saving devices, fixtures and appliances.
- Provide landscape plantings that are drought-tolerant and do not need irrigation.
- Provide a development wide recycling program.
- Control all site lighting with photocells or timers.
- All paints, primers and clear finishes used shall be low volatile organic compound (VOC) type.
- All caulking, sealants and adhesives shall be low VOC type.

# Green Building Criteria

- Composite woods used shall be free of added urea formaldehyde or be encapsulated by a durable low VOC sealant or veneer.
- Carpets shall bear the Carpet and Rug Institute “Green Label” or shall be manufactured from at least 25% recycled materials.
- Bathroom fans shall be Energy Star® labeled and be equipped with a timer.
- Bathroom and kitchen fans and clothes dryers shall be vented directly to the outdoors.
- Provide 15 cubic feet per minute of fresh air per occupant via natural or mechanical means.

# Green Building Criteria

- Heating, ventilation and air-conditioning systems shall be properly sized and certified by a mechanical engineer
- Tankless water heaters, or conventional water heaters with overflow pans shall be provided.
- No piping shall be located outside of the interior finish of the insulated building envelope.
- All domestic water pipes except for PEX piping shall be insulated.
- No mold-propagating materials shall be used in damp areas. Only moisture resistant materials shall be used in bathrooms and at tub-shower surrounds.

# Green Building Criteria

- Provide vapor barriers at all interior slabs on grade.
- Waterproof all below grade spaces shall provide foundation drainage.
- Install passive radon mitigation systems in areas designated as EPA Radon Zone 1 and 2.
- Grading at perimeter of the building shall provide positive drainage away from the building.
- Units with garages shall have an exhaust fan controlled by a carbon monoxide sensor and the demising wall between the garage and living space shall be a continuous air barrier.

# Green Building Criteria

- Termite shields or borate based wood treatment shall be provided with low VOC caulking at all floor joints and penetrations to prevent insect infestation. Chemical soil treatment shall not be used.
- Lead safe work practices shall be used in all properties built before 1978.

# Green Building Criteria

- Provide a maintenance & operations manual and training for all materials, systems and equipment used in the construction, explaining the Green Building components and amenities, how they benefit the property, and how to properly maintain them.
- A Green Building Guide and orientation shall be provided to the residents explaining the Green Building components and amenities and how they benefit from them.

# Tax Credit Awards

- 2007 – 37 Applications
  - 3 Energy Star
  - 4 HERS
  - 30 Green
- 2008 – 33 Applications
  - 32 Green

# *Preservation through Smart Rehab*

- Goal is to reduce consumption and expenses associated with existing affordable housing stock.
- Key – the Energy Audit.
- Recommendations for 10 year payback with identified savings from capital improvements.
- Up to \$500,000 available per property.

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# **IPED HOUSING TAX CREDITS “101”**

## **COMBINING SOLAR AND HOUSING TAX CREDITS**

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# WHY SOLAR ENERGY?

- Solar energy can be used for common areas to reduce a property's operating expenses
- Many states have revised their qualified allocation plans to encourage sustainable building methods (including using solar energy)
- To the extent that using solar energy allows a reduction in tenant utility allowances, that generally allows rents to increase by an equal amount
- The cost of certain solar property may qualify for Energy Tax Credits ("Energy Credits") under Section 48 of the Code

# ENERGY TAX CREDIT BASICS

- Energy Credits constitute the principal federal incentive for developing and installing solar power
- Energy Credits are investment tax credits (based on the cost of the solar energy facility and not on how much electricity is produced)
- The Energy Credit is generally 30% of the cost of the “facility” (which does not include ancillary items like transmission lines and substations, but can include a reasonable development fee)
- The facility must generate electricity, heating/cooling, hot water, or fiber-optic lighting

# ENERGY TAX CREDIT BASICS

- Energy Credits are generally claimed by the owner of the solar facility
- The Energy Credit is generally claimed in full at the time the solar facility is “placed in service”
- Recapture possible for 5 years (credit vests 20% per year)

# RECENT LEGISLATIVE CHANGES

- October 2008 - Bailout Legislation
- American Recovery and Reinvestment Act of 2009

# OCTOBER 2008 “BAILOUT LEGISLATION”

- Extended the solar energy credit for 8 years, so that a qualifying facility must be placed in service prior to **January 1, 2017**
  - The relevant expiration date had been January 1, 2009, until the extension in October 2008
  - Energy Credits can now reduce Alternative Minimum Tax liability (for tax years beginning after October 3, 2008)
  - Energy Credits reduced from 30% to 10% beginning in 2017

# AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

- Solar facilities may be eligible for a 30-percent grant (i.e., a dollar-for-dollar grant from the US Treasury).
  - Construction of the project must begin in 2009 or 2010
  - Treasury must pay the grant within 60 days of the placed-in-service date or the date of the application, if later
  - The project must be placed in service by the deadline that otherwise applies to the particular facility

# AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

- Technical rules that apply to grant program:
  - The grant is not income
  - Expenditures made with the grant are included in basis and eligible for depreciation
- Treasury is authorized to provide repayment rules which would presumably be similar to the five-year (20-percent per year) recapture rule that applies to investment tax credits
- Federal, state, local governments or tax-exempt entities (including partnerships or LLCs which have these entities as partners or members) cannot claim grants

# COMBINING ENERGY AND HOUSING CREDITS

- The same property can take advantage of both Energy Credits and LIHTCs
- If the solar facility is being included in the initial construction or rehabilitation of a LIHTC property, then the solar property can be included in the basis for both tax credits
- If the solar facility is being added to an existing LIHTC property, the LIHTC basis is already established, so the Energy Credit can only be claimed on the solar facility

# ISSUES TO CONSIDER WHEN COMBINING LIHTCs AND SOLAR CREDITS

- Not all properties are good candidates for solar energy
- Charging tenants for the use of electricity will cause the solar equipment to be reclassified as “commercial property” and prevent the solar property from qualifying for LIHTCs
- Energy Credits are allocated in accordance with an owner’s profits (unlike LIHTCs, which follow depreciation)
- The placed-in-service dates for solar property and the building may be different
- Energy credits reduce LIHTC basis

# SELECTING YOUR INVESTOR

- Not all LIHTC investors will buy energy credits
- Developers should decide whether to include solar panels during the early planning stages of a property and solicit investors who value both credits whenever possible
- Several issues with the energy credit vary from investor to investor, including the methodology used to calculate the equity, the timing of the payments, and the due diligence requirements
- Address these issues before selecting your investor to avoid any surprises

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