

## Client Alert

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### New Tax Incentives And Extensions For Renewable Energy Included In Financial Rescue Bill

Renewable energy development got a big boost this month when President Bush signed H.R. 1424, the massive federal economic rescue plan, which also included the Energy Improvement and Extension Act of 2008 ("EIEA"). EIEA included \$10.9 billion in renewable energy tax incentives aimed at clean energy production, as well as \$2.6 billion in tax incentives targeted toward cleaner vehicles and fuels, and \$3.5 billion in tax breaks to promote energy conservation and energy efficiency, according to the Joint Committee on Taxation.

Prior to the passage of EIEA, many of the existing tax credits that are critical to the development of renewable energy were set to expire at the end of 2008. As a result, developers, lenders, and investors had put many large-scale projects on hold.

The following is a brief summary of the most significant renewable energy provisions of EIEA. The summary is not exhaustive. Tax laws of many states will not change, and will be different from federal law.

#### Section 48<sup>1</sup> Energy Credits

**Extension of credits.** EIEA extends the 30 percent tax credits for solar property and fuel cell property and the 10 percent tax credit for microturbine property for eight years; these credits apply to property placed in service through December 31, 2016.

**Expansion of credits.** Three new categories of property are now eligible for the Section 48 energy credit: small wind energy property (which qualifies for a 30 percent credit); combined heat and power system property and geothermal heat pump systems (which each qualifies for a 10 percent credit).

- Qualified small wind energy property is property which uses a small wind turbine to generate electricity. The credit is limited to \$4,000 per year per taxpayer. It applies to property placed in service in years ending after October 3, 2008 through December 31, 2016.
- Combined heat and power system property is property comprising a system (i) which 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); (ii) which produces at least 20 percent of its total useful energy in the form of thermal energy which is not used to produce electrical or mechanical power (or combination thereof), and at least 20 percent of its total useful energy is in the form of electrical or mechanical power (or combination thereof); (iii) the energy efficiency percentage of which exceeds 60 percent; and (iv) which is placed in service before January 1, 2017. It does not include property used to transport the energy source to the facility or to distribute energy produced by the facility. The credit is reduced if the system has a capacity in excess of 15 megawatts (MW) or a mechanical energy capacity of more than 20,000 horsepower (hp), and no credit is allowed if the system has a capacity in excess of 50 MW or a mechanical energy capacity in excess of 67,000 hp.
- Geothermal heat pump system is equipment which uses the ground or groundwater as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure, but only for property placed in service before January 1, 2017.

**Credit may be applied against AMT.** Beginning with taxable years ending after October 3, 2008, Section 48 energy credits may be applied against the alternative minimum tax.

#### Section 45 Renewable Electricity Production Credit

**Extension of credit.** Prior to EIEA, the renewable electricity production credit applied to property placed in service prior to December 31, 2008. For 2008, the credit is 2.1¢ per kilowatt hour, but for

electricity produced and sold at any qualifying facility using open-loop biomass (e.g., agricultural livestock waste nutrients such as poultry waste or solid wood waste materials), small irrigation power, landfill gas, trash combustion or hydropower, the amount of the credit is reduced to 1.0¢ per kilowatt hour. EIEA extends the placed in service date for one year (to December 31, 2009) for wind and refined coal facilities, and for two years (to December 31, 2010) for closed-loop biomass (generally, any organic material from a plant which is planted exclusively for the purpose of being used to generate electricity) facilities, open-loop biomass facilities, geothermal or solar energy facilities, small irrigation power facilities, landfill gas facilities, trash combustion facilities and qualified hydropower production facilities.

**Expansion of credit.** The types of facilities qualifying for the Section 48 credit are expanded to include expansion of existing biomass facilities placed in service after October 3, 2008. The credit is also expanded to include electricity produced and sold after October 3, 2008, in tax years ending after that date, to those facilities placed in service before January 1, 2012 that generate electricity from marine and hydrokinetic renewables such as waves, tides and currents, free flowing water and differentials in ocean temperature (ocean thermal energy conversion).

### Expansion of Allowance for Cellulosic Biofuels Property

Under EIEA, the 50 percent bonus depreciation and exemption from the AMT depreciation adjustment that was provided for qualified cellulosic biomass ethanol plant property is provided instead for qualified cellulosic biofuel plant property. Cellulosic biofuel is any liquid fuel which is produced from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis. The new law applies to property placed in service after October 3, 2008 and before January 1, 2013 in tax years ending after October 3, 2008.

### Modifications to Energy-Related Tax Credit Bonds

Holders of clean renewable energy bonds (CREBs) are entitled to an annual tax credit under Section 54 of the Code. CREBs are issued by cooperative electric companies and governmental bodies. EIEA provides a one-year extension for the issuance of CREBs through December 31, 2009.

EIEA also creates two new categories of qualified tax credit bonds to provide financing for energy-related purposes. Both categories apply to bonds issued after October 3, 2008:

- \$800 million of new clean renewable energy bonds (“New CREBs”) to finance facilities owned by governmental bodies, public power providers and cooperative electric companies that generate electricity from wind, closed-loop biomass, open-loop biomass, geothermal, solar, small irrigation, qualified hydropower, landfill gas, marine renewable and trash combustion facilities. New Section 54C. This measure was designed to help public power agencies, such as the Los Angeles Department of Water and Power, make the change to renewable energy sources.
- \$800 million of qualified energy conservation bonds to finance state and local government initiatives designed to reduce greenhouse emissions. New Section 54D.

### First Year 50 Percent Bonus Depreciation for Investments in Recycling

**New first-year bonus depreciation.** For property placed in service after August 31, 2008, 50 percent first-year bonus depreciation is allowed for qualified reuse and recycling property. “Qualified reuse and recycling property” is any machinery and equipment (not including buildings or real estate) along with all appurtenances, including software necessary to operate such equipment, which is used exclusively to collect, distribute, or recycle qualified reuse and recyclable materials. “Qualified reuse and recyclable materials” means scrap plastic, scrap glass, scrap textiles, scrap rubber, scrap packaging, recovered fiber, scrap ferrous and nonferrous metals or electronic scrap (cathode ray tube, flat panel screen or similar video display devices with a screen size greater than four inches measured diagonally, or any central processing unit) generated by an individual or business. It does not include rolling stock or other equipment used to transport reuse and recyclable materials. It must also be property to which the modified accelerated cost recovery system (MACRS) applies, have a useful life of at least five years, and the original use of the property must begin with the taxpayer after August 31, 2008. It must be acquired by the taxpayer after August 31, 2008 by purchase but only if no written binding contract for such purchase was in effect before September 1, 2008.

**AMT break.** For purposes of determining alternative minimum taxable income for qualified reuse and recycling property, neither the 50 percent first-year bonus depreciation nor any of the other depreciation deductions allowed for the property (in the first year or in later years) is subject to adjustment for AMT purposes.

1 All section references are to the Internal Revenue Code of 1986, as amended (the "Code").

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