

Business Law Update

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Department of Energy Guidance on Qualified Advanced Energy Project Investment Tax Credits

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The U.S. Treasury Department and the Department of Energy (“DOE”) last week issued guidance on the requirements for the new Qualified Advanced Energy Project (“QAEP”) tax credits. This program, which was created by the 2009 American Recovery and Reinvestment Act, provides a 30 percent federal income tax credit for investment in property which “re-equips, expands, or establishes a manufacturing facility” that produces renewable energy property. The QAEP credit is contained in Internal Revenue Code (“IRC”) §48C.

Unlike most other renewable energy tax credits, a taxpayer wishing to claim the QAEP credit must be allocated an amount of credit by the Treasury Department, acting in consultation with DOE. The total amount of QAEP credit available for allocation is limited to \$2.3 billion. The first round of allocations begins August 14, 2009 for 2009-2010. If less than \$2.3 billion of credits are issued in the first round of allocations, an additional round of allocations will be made for 2010-2011.

To qualify for an allocation of QAEP credit in the first round, a taxpayer must submit an application to DOE by September 16, 2009. Once DOE approves and assigns a rank to

the project, an application must be submitted to the Internal Revenue Service by December 16, 2009. The first round of allocations is slated to be made by January 15, 2010.

QAEP Investment Credit Overview

The QAEP credit is an investment-based credit. The credit equals 30 percent of the taxpayer's basis in the property certified as eligible for the credit. There is no maximum tax credit per project. The credit is not refundable and taxpayers may not elect to receive a cash grant in lieu of the credit.

The credit may be claimed in the tax year in which the qualified property is placed in service. In general, property is considered placed in service when it is placed in a condition or state of readiness and availability for a specifically assigned function. Taxpayers may also elect to take the credit early based on qualified progress expenditures paid or incurred during project construction pursuant to Treas. Reg. §1.46-5(o). If the taxpayer does not have sufficient tax liability to utilize the full amount of available credit in the year the project is placed in service, any remaining credit may be carried forward up to 20 years or back one year.

Although a project is not required to be in any particular stage of development to apply for a QAEP credit, a taxpayer has three years from the date of issuance of the certification for the QAEP credit to place the project in service. Any certification is void if the project is not placed in service by the deadline.

As an investment-based credit, the QAEP credit is subject to recapture under IRC §50 if, within five years of being placed in service, the taxpayer disposes of the property (or an interest in the property) or the property ceases to be used for a qualified purpose. The recapture amount reduces by 20 percent each year, resulting in no recapture in year six.

The "at risk" rules of IRC §49 also apply to the credit. These rules limit the credit to the amount the taxpayer is at risk with respect to the credit property. A taxpayer is generally considered at risk to the extent of the taxpayer's investment in the property or to the extent the taxpayer has liability for property financing or the property is financed with qualified nonrecourse financing. Accordingly, the at risk rules should be considered when deciding how to finance property construction.

Eligibility for QAEP Credit

To qualify for QAEP credit, property must be used to re-equip, expand or establish a manufacturing facility for the production of specified advanced energy property or property that, after further manufacture, will become specified advanced energy property. Components may be specified "advanced energy property," but the relative

value of the components to the finished product will be taken into consideration in the DOE ranking process described below.

Specified energy property is:

- Property designed for use in the production of energy from the sun, wind, geothermal deposits or other renewable resources;
- Fuel cells, microturbines, or an energy storage system for use with electric or hybrid-electric motor vehicles;
- Electric grids to support the transmission of intermittent sources of renewable energy, including property for the storage of such energy;
- Property designed to capture and sequester carbon dioxide and sequester carbon dioxide emissions;
- Property designed to refine or blend renewable fuels (but not fossil fuels) or to produce energy conservation technologies (including energy-conserving lighting technologies and smart grid technologies);
- New plug-in electric drive motor vehicles, qualified plug-in electric vehicles, or components designed specifically for use with such vehicles, including electric motors, generators, and power control units; or
- Other property designed to reduce greenhouse gas emissions as may be determined by the IRS.

The property must be tangible property (other than a building or its structural components) subject to the allowance for depreciation or amortization, and must be an integral part of the qualifying project. A manufacturing facility is defined as a facility that makes or processes raw materials into finished products (or accomplishes any intermediate stage in that process).

DOE Recommendation and Ranking

The IRS will not review an application for a credit allocation unless the DOE has provided a recommendation and ranking for the project. Accordingly, a taxpayer seeking an allocation of credit for a project must first submit to the DOE a two-part application for recommendation. The DOE will provide a ranking (in descending order) of all projects for which it provides a recommendation. Credits will be fully allocated to a higher ranked project before any credits are allocated to the next project on the list.

For the first round of credit allocations, preliminary applications must be submitted to the DOE by September 16, 2009 and final applications must be submitted by October 16, 2009. The format of the DOE application is specified on the DOE's website. The application must include a "project information memorandum" of no more than 30 pages that specifies how the project is eligible and how the project should be evaluated under the criteria specified by the DOE in its guidance. The DOE's guidance discourages elaborate art work and graphics.

The DOE will also consider the following four factors, equally weighted, in making its recommendation and ranking determinations:

- Projects that provide the greatest domestic job creation (both direct and indirect) during the credit period (February 17, 2009, through February 17, 2013);
- Projects that provide the greatest net impact in avoiding or reducing air pollutants or anthropogenic emissions of greenhouse gases;
- Projects that have the greatest potential for technological innovation and commercial deployment, as indicated by (i) the production of new or significantly improved technologies, (ii) improvements in levelized costs and performance, and (iii) manufacturing significance and value; and
- Projects that have the shortest projected time from certification to completion.

In addition, the DOE will consider the following four policy factors:

- Geographic diversity;
- Technology diversity;
- Project size diversity; and
- Regional economic development.

The DOE will also assess the commercial viability of the project. An applicant should describe the economic factors relevant to the project and show how the project is economically viable. The application should include as attachments:

- A business plan that describes the project; and
- A financial plan for the project.

Participation in DOE loan guarantee programs generally will not be considered a negative factor for the commercial viability of the project.

IRS Certification and Allocation

Applicants must also make a separate filing with the IRS for certification of the project and allocation of the credit. The submission, on IRS Form 2468, is due no later than December 16, 2009. If the IRS accepts an application for certification, the IRS should notify the taxpayer by letter. The date of the letter is deemed to be the "acceptance date." The taxpayer will then be required to execute an agreement with the IRS (by March 15, 2010 for credits allocated in the first allocation round). The IRS will execute and return the agreement by April 16, 2010. Any successor in interest to the applicant will be required to execute a new agreement.

Taxpayers whose applications for certification are accepted will have one year from the acceptance date to provide documentation establishing that the following requirements for certification have been met:

- The taxpayer has received all federal, state, and local permits, including environmental authorization or reviews necessary to commence construction of the project; and
- The taxpayer has completed all steps that must be accomplished during the one-year period beginning on the acceptance date if the project is to be placed in service before the end of the three-year period beginning on the date of issuance of the certification (assuming such certification will be issued on the one-year anniversary of the acceptance date).

If these requirements are satisfied, the IRS will then decide whether to certify the project. The date of the IRS letter certifying the project is considered the date of certification, which begins the three-year period for placing the project in service.

Key Dates

Preliminary application due to DOE	September 16, 2009
Final application due to DOE	October 16, 2009
DOE review complete / IRS application due	December 16, 2009
IRS to accept or reject application	January 15, 2010
Agreement with IRS signed by applicant	March 15, 2010
Agreement executed by IRS	April 16, 2010

The DOE and Treasury guidance is extremely complicated and has numerous qualifications and exceptions. Taxpayers interested in submitting an application should begin the process early and contact members of the Taylor English Duma Renewable Energy Finance Team as soon as possible.

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