



# Client Alert

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## GEORGIA AND FEDERAL ENERGY TAX CREDITS AND GRANTS June 2009

In a very short time period, the Federal Government and the State of Georgia have adopted or expanded a number of income tax credits, grants and subsidized financing programs that are available for renewable energy projects. The following is a brief overview of the new federal and Georgia tools available to assist and encourage renewable energy projects in Georgia.

### I. Federal Energy Tax Credits

The Investment Tax Credit (the "Investment Energy Credit") authorized by Section 48 of the Internal Revenue Code (the "Code") and the Production Tax Credit (the "Production Credit") authorized by Section 45 of the Code have been the federal income tax credit incentives for the installation and operation of renewable energy projects. The American Recovery and Reinvestment Act of 2009 ("ARRA") has made both types of credits (but particularly the Investment Energy Credit) even more attractive to use, because taxpayers developing and investing in renewable energy facilities can realize more value from the credits and also now have more options in structuring these transactions. Following on the favorable amendments set forth in last October's Energy Improvement and Extension Act of 2008 ("EIEA"), the federal government is providing additional incentives for the rapid development of renewable energy facilities such as solar photovoltaic panels, solar thermal heating, photovoltaic generation facilities, wind farms, geothermal and other alternative energy technologies.

The Investment Energy Credit historically has been available primarily to taxpayers owning or investing in solar electric and heating equipment. The amount of the Investment Energy Credit is generally 30 percent of the "Eligible Cost Basis" of the subject facilities, with no maximum limit on the dollar amount of the credits. The basis consists of the aggregate cost of the investment to the taxpayer, regardless of how much electricity is actually produced or sold from the facility – if any. The requirement is simply that funds be invested in a facility that is "placed in service" and generates electricity for heating, cooling or lighting. Typical ancillary installations or equipment such as transmission lines or substations are not included when calculating the eligible basis; however, a reasonable development fee can be included. Although the full amount of the Investment Energy Credit is available in the year in which the facility is actually placed in service, this credit vests at 20% per year, so recapture of the credits received is possible if the facility is sold or otherwise disposed of during the first five years after it is placed in service.

For many other renewable energy sources, such as large-scale wind, geothermal, biomass and other non-solar energy production facilities, the Production

Credit has been the traditional primary incentive available to the developer. A potential negative aspect of the Production Credit is that, as its name implies, the amount of credit is a function of the amount of electricity produced by the facility. ARRA, however, now permits the owner of a facility otherwise eligible for the Production Credit to elect to use the Investment Energy Credit instead, thereby permitting the amount of the credit to be determined solely by reference to the cost basis of the facility as opposed to its actual electricity production.

Before the EIEA, it was necessary for a facility to be placed in service before January 1, 2009 in order to be eligible for the Investment Energy Credit, and Production Credits were only available for projects placed in service before 2011 or earlier, depending upon the type of facility involved. Last fall, the EIEA extended the placed in service deadline for purposes of the Investment Energy Credit to December 31, 2016. ARRA has also extended the placed in service deadline for projects claiming Production Credits to 2012 for wind facilities and 2013 for other projects eligible for Production Credits.

Another significant improvement under ARRA is the elimination of the so-called "subsidized financing penalty" for purposes of the Investment Energy Credit. Previously, the use of state bonds, grants, below market loans, various forms of other "subsidized financing" or other types of tax credits would reduce the eligible basis of the property (and thus, the allowable credits) pro rata, based on the percentage of the facility using or benefitting from the installations funded with the deemed subsidy. This has now been repealed under ARRA for purposes of the Investment Energy Credit. Taxpayers can now calculate the credit by reference to the full Eligible Cost Basis of the facility, regardless of the existence and type of other financing sources including state and local grants. This has the potential of increasing the economic value of these credits by 30-50% and makes them useable in a much wider range of projects already receiving favorable government financing through tax-exempt bonds (such as Recovery Zone Facility Bonds) or certain HUD programs. It should be noted, however, that the amount of Eligible Cost Basis of property for the Production Credit continues to be subject to reduction as a result of grants and other subsidies that are financing sources for such projects. ARRA did not modify these subsidy rules as they relate to the Production Credit.

Although the Owner of the facility is typically the party that claims the Investment Energy Credit or the Production Credit, the parties who actually develop and operate a facility often do not have sufficient taxable income to benefit from claiming the credits. Also, because ARRA did not change the passive loss rules for individual taxpayers with respect to the credits, the value of the credits to individuals remains limited. The ownership of renewable energy facilities can be structured, however, so that they are owned and operated through a master lease structure or by one or more entities that are treated as a partnership for federal income tax purposes. An investor or a fund composed of a group of investors can be admitted as a partner that contributes a significant portion of the capital used to pay for the construction of the facility (and the payment of an appropriate developer fee to the developer). The contributing investor partner then receives an allocation of substantially all of the tax credits for which the project is eligible. The amount of the capital contribution from the investor partner generally corresponds to the amount of credits being allocated.

There are myriad tax and business issues, and accompanying documentation costs, associated with structuring transactions so as to deliver the maximum amount of credits to the investor. One primary concern is that the credits must be allocated in accordance with the "profits interest" of the partners in a partnership, meaning that for an investor to receive 99% or more of the credits allocated to that investor, the investor must own a 99% or more profits interest. A variety of subsidiary issues also arise in the context of structur-

ing the ownership so as to satisfy the “profits interest” requirement while at the same time achieving the developer’s goal of receiving the maximum flow of cash distributions and compensation paid from the operation of the facility.

After ARRA, however, the developer has an additional option that enables it to perhaps avoid the need to restructure the ownership to deliver credits to an investor as a means for raising capital. ARRA now allows the owner to choose either (1) the Investment Energy Credit or the Production Credit, or (2) to elect to “monetize” the credits by receiving a payment from the federal government, which is somewhat confusingly referred to as a “grant.” These payments should not be confused with the ARRA grants available through the State of Georgia (described below under “Georgia Grants from ARRA Funds”).

The amount of this grant is equal to 30 percent of the qualified tax basis of most types of renewable energy facilities, with no overall dollar limit. This is especially advantageous to entrepreneurial developers who do not have the need for the credits themselves and cannot find a suitable tax credit investor partner. The grant only works, however, for projects that are ready to go forward in the next couple of years. In order to obtain this type of grant, an application must be filed with the Treasury Department by October 1, 2011, construction of the project must have begun before the end of 2010 and the facility must be placed in service by a specified deadline of December 31, 2012 for wind facilities eligible for the Production Credit; December 31, 2013 for all other facilities eligible for the Production Credit and December 31, 2016 for facilities eligible for the Investment Energy Credit.

These payments from the U.S. government are not paid out until 60 days after the later of the date the facility is placed in service or the grant application date. Because a developer will not receive the grant funds in any event until the facility is completed, it will be necessary to use some sort of bridge financing to finance construction needs. The ARRA conference agreement indicates that if the taxpayer elects to receive a grant, it will not be included in taxable income; however, the tax basis of the property will be reduced in an amount equal to 50% of the grant.

## **II. Georgia Energy Tax Credits**

In addition to the federal tax credits described above, in 2008 Georgia adopted its own income tax credits for investments in “clean energy property.” O.C.G.A. 48-7-29.14. Clean energy property includes:

- (a) a wide array of solar energy equipment;
- (b) Energy Star certified geothermal heat pump systems;
- (c) energy-efficient projects, such as lighting retrofit projects and energy-efficient buildings;
- (d) wind energy equipment, and
- (e) biomass equipment to convert wood residuals and other biofuels into electricity through gasification and pyrolysis.

For property used for other than single family residential purposes, the Georgia tax credit is limited to the lesser of (a) 35% of the cost of the “clean energy property” or (b):

- (i) \$500,000 per installation for solar energy, solar thermal electric applications, wind and biomass equipment;
- (ii) \$100,000 per installation for domestic water heating;
- (iii) \$100,000 for Energy Star certified geothermal heat pump systems;
- (iii) \$.60 per square foot of the building for a lighting retrofit project with a maximum of \$100,000; and
- (iv) \$1.80 per square foot of the building for an energy-efficient building project with a \$100,000 maximum.

In essence, the tax credits for solar energy, solar thermal applications, wind and biomass equipment are capped at \$500,000 and the remainder are capped at \$100,000.

The Georgia tax credits are available on a first come, first served basis. Unfortunately, under current law, the total Georgia tax credits available to all taxpayers is limited to \$2,500,000 for each of the 2008-2012 tax years. The state credits can be combined with the Federal tax credits, but cannot be claimed for property already obtained with the Georgia grants of ARRA funds. The Georgia tax credits are not refundable or generally transferrable; however, if the credits exceed a Georgia taxpayer's income tax liability, the excess Georgia tax credits can be offset against the taxpayer's Georgia payroll withholding taxes.

### **III. Georgia Grants of ARRA Funds**

Georgia is eligible for approximately \$82.5 million in ARRA funding for its State Energy Program (SEP) and \$124.8 million for its low-income home Weatherization Assistance Program (WAP). In addition, large Georgia counties and cities are directly eligible for approximately \$45.5 million of Energy Efficiency and Conservation Block Grants (EECBGs). Smaller Georgia counties and cities are eligible for approximately an additional \$21.6 million. The SEP and WAP funds, and the \$21.6 million of the EECBGs available to smaller counties and cities, will be administered by the Georgia Environmental Facilities Authority (GEFA).

#### **SEP Grants**

The allocation of the SEP grant funds will be as follows:

- State Facilities Retrofit Program - \$65,000,000
- Clean Energy Project Grant Program (HB473) - \$4,495,000
- Renewable Energy Grants - \$4,000,000
- Commercial Energy Efficiency Grants - \$2,000,000
- Industrial Energy Efficiency Grants - \$2,000,000
- Residential Energy Efficiency Grants - \$2,000,000
- Governor's Energy Challenge - \$1,008,052
- Energy Building Codes Update and Compliance - \$1,000,000
- Program Management - \$991,948.

Grants will be awarded through an open, competitive application process, but will not begin until the U.S. Department of Energy has approved Georgia's SEP plan and awarded the ARRA funds to GEFA.

Over 78% of the SEP grants will be used for the State Facilities Retrofit Program. Private sector organizations may apply for the following:

- Clean Energy Property Grants
- Renewable Energy Grants
- Commercial Energy Efficiency Grants
- Industrial Energy Efficiency Grants, and
- Residential Energy Efficiency Grants.

## **Georgia Clean Energy Property Grants**

Georgia recently adopted O.C.G.A. 50-23-21, which provides a framework for the Georgia \$4,495,000 Clean Energy Property Grant Program. The definition of the "clean energy property" for which the grants can be used and the limits for the Clean Energy Property Grants are the same as those for the Georgia energy tax credits described above, except that "business equipment to convert wood residuals into electricity through gasification and pyrolysis" is deleted. Although these grants can be used in combination with the Federal tax credits described above, recipients of grants under this program may not also claim a Georgia clean energy property tax credit for the same property. Georgia's Clean Energy Property Grants will be awarded on a first come, first served basis; however, the application process is not expected to begin before July 12, 2009. The clean energy property then must be placed in service before December 31, 2012.

## **Energy Efficiency and Conservation Block Grants**

Cities with population of less than 35,000 and Counties with population of less than 200,000 may apply to GEFA for EECBGs up to a total of approximately \$21.6 million. Larger cities and counties will apply directly to the Energy Efficiency and Renewable Energy Office of the U.S. Department of Energy for a total of approximately \$45.6 million of such grants.

Investing in Georgia renewable energy is more economically and financially attractive than ever before, after the passage of ARRA. Combinations of federal and Georgia tax incentives, grants and federally assisted financing alternatives as described above can be utilized to substantially reduce the capital and financing costs of renewable energy investments and projects. The rules governing these incentives remain very technical in several areas and the Internal Revenue Service is providing some guidance in installments.

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