Climate Change and Clean Technology Blog

Posted at 5:42 AM on February 2, 2011 by Sheppard Mullin

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 and its effect on the Energy Sector

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On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act"). The Act contains a myriad of provisions, including extending the Bush-era tax rates, and is expected to have an $858 billion impact. It passed 81-19 in the Senate and 277-148 in the House.

The Act extends several key tax incentives which help to promote the clean technology sector. Many of the energy incentives extended by the Act were first put into action by the American Recovery and Reinvestment Act of 2009, more widely known as the "Stimulus Package." However, some date back further, like the tax incentive for use of ethanol in fuel, which dates back to the American Jobs Creation Act of 2004. The tax incentives offered in the Act serve to create jobs in clean technology, reduce U.S. dependence on foreign oil, incentivize the move towards efficient and clean production of energy and alternative fuel sources, and incentivize the use of energy-efficient products.

Summary of the Sections affecting Energy

Section 701 – Biodiesel Fuel. This section extends through 2011 the $1.00 per gallon production tax credit for biodiesel fuel. It additionally extends the small agri-biodiesel producer credit of 10 cents per gallon and the $1.00 per gallon production tax credit for diesel fuel created from biomass. Biodiesel fuel is a renewable, low carbon diesel replacement fuel, and is the only domestically produced, commercial scale fuel that qualifies as an Advanced Biofuel under the Renewable Fuel Standards. This credit has led to an increase in the production and use of biodiesel in the U.S., which went from producing approximately 25 million gallons of biodiesel fuel in 2004 to 545 million gallons in 2009. This increase in production has helped spur the creation of green jobs, helped to reduce pollution (the EPA estimates that biodiesel fuel can reduce carbon pollution by up to 85%), and is helping to reduce our dependence on foreign oil.

Section 702 – Coal Refineries. This section extends for two years (through 2011) the credit for new refined coal facilities under Section 45 of the Internal Revenue Code. This extension applies to facilities placed in service after December 31, 2009, and before January 1, 2012, and grants a credit of 1.5 cents multiplied by the kilowatt hours of electricity produced by the taxpayer from qualified energy resources, for a ten year period after the facility was placed in service. To qualify, the refined coal must achieve a reduction of at least 20% of the emissions of nitrogen oxide and at least 40% of the emissions of either sulfur dioxide or mercury when burned. This credit will help to spur the commercial generation and use of cleaner coal technology, thus reducing pollution and helping to obtain better energy security for the U.S..

Section 703 – New Energy-Efficient Homes. This section extends through 2011 the new energy efficient home credit. This credit grants up to $2,000 for builders of all new energy-efficient homes, including certain manufactured homes. To qualify, the home must be located in the U.S., have been substantially completed after August 8, 2005, and have been acquired from an eligible contractor after December 31, 2009, and before January 1, 2012. Site built homes must reduce heating and cooling energy consumption by 50% relative to the International Energy Conservation Code standard in order to be eligible for the credit. This credit incentivizes builders to ensure that the homes they build are energy-efficient.

Section 704 – Alternative Fuels. This section extends through 2011 the 50 cent per gallon tax credits for alternative fuel and alternative fuel mixtures, excluding biodiesel fuel and fuel derived from the production of paper or pulp. This credit is designed to incentivize production of alternative fuels in the U.S., and doesn't apply to fuel produced outside the U.S.. Included as alternative fuels are liquefied petroleum gas, P Series Fuels, compressed or liquefied natural gas, and liquefied hydrogen, among others. This extension promotes the effort to increase the number of natural gas vehicles (NGVs) used in the United States. NGVs, particularly heavy-duty vehicles for waste hauling, transit and trucking, help to reduce dependence on foreign oil, because roughly 98% of the natural gas consumed in the U.S. is sourced in the U.S. or Canada. Natural gas costs less than diesel or gasoline, and it produces up to 30% lower greenhouse gas emissions in light-duty vehicles, and up to 23% lower greenhouse gas emissions in medium- to heavy-duty vehicles.

<u>Section 705 – Electric Utilities</u>. This section of the Act extends a rule providing deferred gain recognition on the sale or other disposition of property used by a qualified electric utility to an independent transmission company. This rule now applies to dispositions made before January 1, 2012. "Qualifying electric transmission transaction" means any sale or other disposition of property used in the business of providing electric transmission services, provided the sale is to an independent transmission company. "Independent transmission company" means an independent transmission provider approved by the Federal Energy Regulatory Commission, or a person who the Federal Energy Regulatory Commission determines in its authorization of the transaction is not a market participant, and whose transmission facilities are under the operational control of a Federal Energy Regulatory Commission-approved independent transmission provider.

<u>Section 706 – Marginal Wells Depletion Deduction</u>. This section further suspends the limitation on the percentage depletion deduction for oil and gas from marginal wells. A marginal well is one that is nearing the end of its economically useful life. Taxpayers are permitted to recover their investments in marginal oil and gas wells through depletion deductions. This deduction is usually limited to 100% of the net income from the property, but Congress suspended that limitation through 2009. This provision further extends this suspension on the 100% limitation to apply to tax years beginning before January 1, 2012, and retroactively applies the extension for tax year 2010. Thus, taxpayers may use this depletion deduction for an amount greater than 100% of the net income of the property. This deduction is crucial to the economic viability of marginal wells, because marginal wells may produce up to nine barrels of water for every barrel of oil produced, making operating and maintenance costs prohibitive without this deduction, yet marginal wells are still important because they account for about 20% of domestically produced oil and 12% of domestically produced natural gas. Further, marginal wells account for 80% of all oil wells and 66% of all gas wells in the U.S..

<u>Section 707 – Cash Grant in Lieu of Credit</u>. This section extends for one year (through 2011) the start of construction deadline for the cash grant in lieu of tax credit, which was established in Section 1603 of the American Recovery and Reinvestment Act. This program allows existing tax credits for renewable energy to be converted into an up-front payment from the Treasury Department. This program benefits renewable energy developers who face large up-front capital costs, and who were struggling to find financial institutions willing to monetize their tax credits in this strained economy. This cash grant program has significantly increased renewable energy installations. For example, 2009 saw an increase of 20% over 2008 for new wind power installations. Under this extension, eligible renewable projects must begin construction by December 31, 2011. However, a number of in-service deadlines still apply.

<u>Section 708 – Alcohol as Fuel</u>. This section extends through 2011 certain income tax credits for alcohol used as fuel. It extends the per-gallon tax credits and outlay payments for ethanol, the existing tariff on imported ethanol, and the related tariff on ethyl tertiary-butyl ether. These tax credits allow ethanol to be cost-competitive with gasoline, and provides protection against the volatility of the petroleum fuel market. This incentive helps to ensure job creation while providing a domestically produced alternative to foreign oil. Additionally, because the tax benefit is available for all types of ethanol, not just corn and sugar-based ethanols, it allows for new and innovative types of ethanol to be developed more economically.

<u>Section 709 – Energy-Efficient Appliances</u>. This section extends through 2011 and modifies standards for the Internal Revenue Code Section 45M credit for U.S.-based manufacture of energy-efficient appliances, specifically dishwashers, clothes washers and refrigerators. As to dishwashers, it adds to the credit certain dishwashers produced in 2011, ranging from a $25 credit to a $75 credit depending on the amount of energy and water used per cycle. As to clothes washers, it adds to the credit those manufactured in 2011, with a credit ranging from $175 to $225, again depending on the amount of water and energy consumed by the machine. It further extends the credit to certain refrigerators manufactured in 2011, which, depending on the percentage reduction in energy use from the 2001 energy conservation standards, can be eligible for either a $150 or $200 tax credit. Prior to this extension, the credit was limited to 2% of the taxpayer's average annual gross receipts for the three years prior to claiming this credit, but this has been increased to 4%. This credit incentivizes

consumers to choose energy-efficient appliances when replacing their old appliances.

Section 710 – Energy-Efficient Home Improvements. This section extends for one year the credit under Section 25C of the Internal Revenue Code for energy efficient improvements to existing homes, but utilizes the credit structure and credit rates that existed prior to the enactment of the American Recovery and Reinvestment Act of 2009. Additionally, certain efficiency standards that were weakened in the American Recovery and Reinvestment Act are restored to their prior levels. Lastly, the provision provides that windows, skylights and doors that meet the Energy Star standards are qualified improvements. This credit is only available for energy efficient improvements made to the taxpayer's principal residence located within the U.S.. The improvements must be placed into service after December 31, 2008, and before January 1, 2012. The credit applies to improvements such as adding insulation, energy-efficient exterior windows and energy-efficient heating and air conditioning systems; however, labor costs cannot be included in calculating the credit. Manufacturers must certify that their products meet new standards and they must provide a written statement to the taxpayer evidencing the same. This credit makes it more economically feasible for taxpayer's to update their homes to be more energy-efficient, and incentivizes them to do so.

Section 711 – Alternative Fuels Refueling Property. This section extends through 2011 the tax credit for qualified alternative fuel vehicle (QAFV) refueling property. QAFV refueling property is property used for the storage or dispensing of a clean burning vehicle fuel such as propane, natural gas, or even electricity, but only if the storage or dispensing of the fuel is at the point where such fuel is delivered in the fuel tank of the motor vehicle. Qualifying fuels are defined as any fuel with at least 85% volume consisting of ethanol, natural gas, CNG, LNG, LPG, hydrogen and any mixture of diesel fuel and biodiesel containing at least 20% biodiesel. For personal use property, the credit is generally the smaller of 30 percent of the property’s cost or $1,000. For business use property, the credit is generally the smaller of 30 percent of the property’s cost or $30,000. This credit allows consumers to receive the benefit of the tax credit on alternative fuels even where they provide their own fueling station, rather than forcing them to wait until fueling facilities are being built to offer them places to buy their fuel. It further incentivizes the building of commercial alternative fuels refueling stations.

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