

Client Alert

Global Transactions Practice Group

January 4, 2013

Wind Power and Biofuel Production Tax Credits Survive Fiscal Cliff

Introduction

On January 1, 2013, amid much contentious debate, Congress enacted the American Taxpayer Relief Act of 2012 (H.R. 8) (the "Relief Act"). Although the Relief Act does not comprehensively address U.S. energy policy issues, it does extend important federal tax credits for renewable energy projects, including projects that produce wind power, blend biodiesel, and produce cellulosic "second generation" biofuel. This Client Alert will summarize certain energy tax incentives relevant to wind, biodiesel and biofuel project developers that the Relief Act extends, modifies or revives.

Extension of Production Tax Credits for Wind Power

As authorized by the Energy Policy Act of 1992 and subsequently amended, Section 45 of the Internal Revenue Code provides a 10-year, inflation-adjusted production tax credit to qualified tax paying owners of certain types of renewable power generating projects ("Section 45 projects"), including (among others) wind, closed- and open-loop biomass, geothermal, landfill gas, qualified hydropower, and marine and hydrokinetic facilities. The Relief Act extends through the year 2013 the existing production tax credit (PTC) of \$0.02 cents for every kilowatt hour of electricity produced by wind generation projects that begin construction by the end of 2013. Previously, such tax credit was only available to wind power generation projects that completed construction and were placed into service by the end of 2012. The Relief Act does not make clear what constitutes "beginning construction". However, under rules promulgated by the Treasury Department for awarding cash grants for Section 45 projects under Section 1603 of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5) (discussed further below), "beginning construction" requires an applicant to begin "physical work of a significant nature" or pay or incur 5% or more of the project's eligible basis by the "begin construction" deadline.¹ Similar such rules may be adopted by the IRS in connection with determining whether construction has begun for wind production facilities.

The uncertainty around whether the PTC would remain in effect has resulted in record wind turbine installations during 2012, but is also expected to cause a decline of installations in 2013 relative to previous years, based on low

For more information, contact:

Kenneth S. Culotta
+1 713 276 7374
kculotta@kslaw.com

Thomas J. Spulak
+1 202 661 7948
tspulak@kslaw.com

Archie Fallon
+1 713 276 7301
afallon@kslaw.com

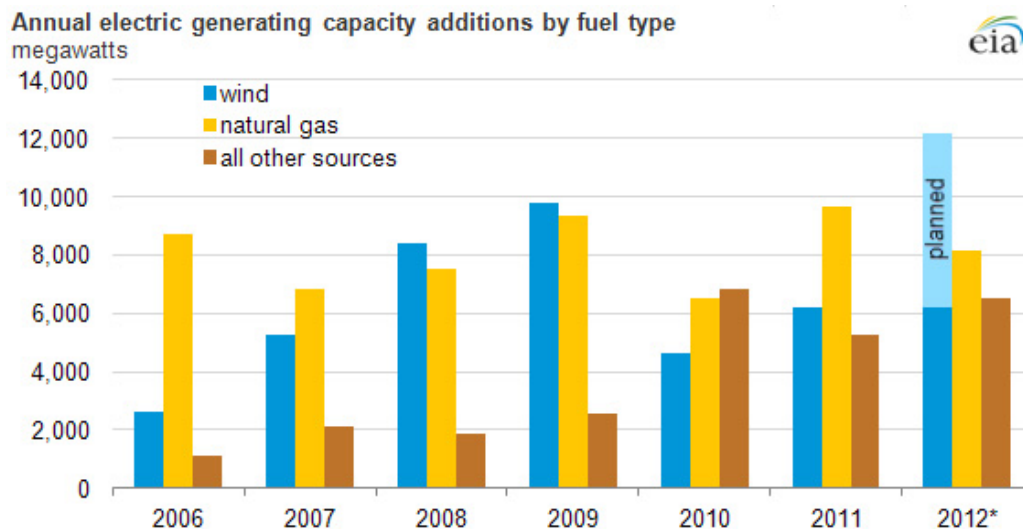
King & Spalding
Houston
1100 Louisiana Street
Suite 4000
Houston, Texas 77002-5213
Tel: +1 713 751 3200
Fax: +1 713 751 3290

www.kslaw.com

Client Alert

Global Transactions Practice Group

supply chain volume for 2013 reported by manufacturers.ⁱⁱ According to the Energy Information Administration, if all planned wind generation for 2012 comes on line, wind capacity additions could top 12,000 MW for 2012. This would account for 45% of total power capacity additions and exceed capacity additions from any other fuel source, including natural gas, which was the leading fuel source for electric generating capacity additions in 2010 and 2011.



Source: U.S. Energy Information Administration, *Annual Electric Generator Report (Form EIA-860) and Monthly Update to the Annual Electric Generator Report (Form EIA-860M)*.

***Note:** 2012 data include both completed and planned projects, with data as of November 30, 2012.

The Relief Act does not significantly affect the investment tax credit (ITC) program under Section 48 of the Internal Revenue Code, which reduces federal income taxes for qualified owners of Section 45 projects based on capital investment in such projects, including wind projects. Such a project may be eligible to receive an ITC of up to 30% of such project's qualifying capital investment. PTC-eligible projects can elect to receive the ITC instead of the PTC, but may not receive both. A project electing to receive an ITC must be placed into service by December 31, 2016.

Further, the Relief Act does not modify or extend the so-called "1603 Grant" program enacted under Section 1603 of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5), a popular alternative to receiving an ITC, whereby an ITC-eligible project could receive a cash grant from the Department of the Treasury equal to the amount of the ITC it is otherwise entitled to receive. It is still the case that a project must have begun construction before the end of 2011 in order to be eligible for a 1603 Grant.

Revival of Biodiesel Income Tax Credit and Blenders' Excise Credit

The Relief Act revives, retroactively makes effective in 2012 and extends through the end of 2013 the (i) biodiesel income tax credit of \$1.00 per gallon of qualifying biodiesel and renewable dieselⁱⁱⁱ and (ii) excise tax credit for qualifying biodiesel and renewable diesel fuel mixtures.^{iv} Although such credits had previously expired at the end of

Client Alert

Global Transactions Practice Group

2011, the Environmental Protection Agency's (EPA) decision in September of 2012 to raise the Renewable Fuel Standard for the amount of biodiesel that refiners must blend with their products in 2013 to 1.28 billion gallons (from 1.0 billion gallons) helped drive Congressional action to revive such credits.^v

A brief summary of certain qualifications for such credits follows:

A producer that is registered with the Internal Revenue Service (IRS) and that delivers pure, unblended biodiesel (B100) into the tank of a vehicle or uses B100 as a fuel in its trade or business may be eligible for an incentive in the amount of \$1.00 per gallon of biodiesel, agri-biodiesel, or renewable diesel. If the biodiesel was sold at retail, only the person that sold the fuel and placed it into the tank of the vehicle is eligible for the tax credit. The incentive is allowed as a credit against the taxpayer's income tax liability. Claims for the credit must include a copy of the certificate from the registered biodiesel producer that: identifies the product; specifies the product's biodiesel, agri-biodiesel, and/or renewable diesel content; confirms that the product is properly registered as a fuel with the U.S. Environmental Protection Agency (EPA); and confirms that the product meets the requirements of ASTM specification D6751.

A biodiesel blender that is registered with the IRS may be eligible for a tax incentive in the amount of \$1.00 per gallon of pure biodiesel, agri-biodiesel, or renewable diesel blended with petroleum diesel to produce a mixture containing at least 0.1% diesel fuel. A blend of 99.9% biodiesel and .1% diesel fuel qualifies as a mixture, and can be claimed by a blender. Only blenders that have produced and sold the qualified biodiesel mixture or used the qualified biodiesel mixture as a fuel in their trade or business are eligible for the tax credit. The incentive must first be taken as a credit against the blender's fuel tax liability; any excess over this tax liability may be claimed as a direct payment from the IRS. Claims must include a copy of the certificate from the registered biodiesel producer or importer that: identifies the product; specifies the product's biodiesel, agri-biodiesel, and/or renewable diesel content; confirms that the product is properly registered as a fuel with the EPA; and confirms that the product meets the requirements of ASTM specification D6751.

Extension of "Second Generation" Biofuel Production Credits and Allowances

The Relief Act also extends through the end of 2013 the cellulosic biofuels production credit, commonly referred to as the "second generation biofuel producer credit".^{vi} Such credit is available to qualifying producers of biofuel from non-food based feedstock, and is equal to \$1.01 per gallon of qualifying production. The Relief Act also expands the scope of qualifying production to include liquid fuel derived from cultivated algae, cyanobacteria, or lemna. Further, the Relief Act extends through the end of 2013 a special allowance under the Food, Conservation, and Energy Act of 2008 (Public Law 110-246) for accelerated depreciation of qualifying cellulosic biofuel plant property placed into service before the end of 2013.^{vii}

Celebrating more than 125 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 800 lawyers in 17 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality and dedication to understanding the business and culture of its clients. More information is available at www.kslaw.com.

This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice.

Client Alert

Global Transactions Practice Group

ⁱ See Department of Treasury, Frequently Asked Questions and Answers “Beginning of Constructions (available at: <http://www.treasury.gov/initiatives/recovery/Documents/K%20FAQs%20for%20Begun%20Construction.pdf>).

ⁱⁱ See Energy Information Administration, *Planned wind turbine additions rise in advance of scheduled expiration of wind tax credit* (December 19, 2012) (available at: <http://www.eia.gov/todayinenergy/detail.cfm?id=9270#>); *Vestas commends President Obama and U.S. Congress on PTC extension* (January 2, 2013) (available at: <http://www.vestas.com/en/media/news/news-display.aspx?NewsID=3205&action=3>). This presumably will not significantly slow the “beginning of construction” of projects in 2013, as developers likely will be able to capture the PTC benefit by undertaking site preparation in 2013 and take delivery of equipment afterwards.

ⁱⁱⁱ See Section 405(a) and (c) of the Act (amending 26 U.S.C. 40A).

^{iv} See Section 405(b) and (c) of the Act (amending 26 U.S.C. 6426).

^v See 40 CFR Part 80 (Final Rule, September 27, 2012).

^{vi} See Section 404 of the Act (amending 26 U.S.C. 40(b)(6)). Section 404 formally replaces references to “cellulosic” in 26 U.S.C. 40(b)(6) with the phrase “second generation”.

^{vii} See Section 410 of the Act.