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Renewable Energy Projects: Maximizing Investment and Production Tax Credits

Strategies for Leveraging Federal Tax Benefits, Incentives and New IRS Guidance

WEDNESDAY, OCTOBER 26, 2016

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Today's faculty features:

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Renewable Energy Projects: Maximizing Investment and Production Tax Credits

Strafford Webinars

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Mr. Binstock advises public and private companies on a broad range of domestic and international U.S. federal income tax issues, with particular focus on mergers, acquisitions, dispositions, joint ventures, integration and restructuring transactions, debt and equity offerings, information reporting and tax-equity financings. He has significant experience with tax issues associated with partnership taxation and renewable energy tax benefits.

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Paul Schockett advises public and private companies on a broad range of U.S. federal income tax matters, with particular focus on U.S. and cross-border transactions. Mr. Schockett's practice includes significant work involving the tax aspects of partnership acquisitions and dispositions, joint venture and investment fund formations, and corporate mergers and acquisitions. He also advises clients with regard to the taxation of debt and equity financings, initial public offerings, bankruptcy restructurings and internal reorganizations.

Mr. Schockett frequently writes and lectures on tax-related topics, including partnership taxation, M&A transaction structuring, tax aspects of troubled company workouts, and renewable energy tax benefits.

Agenda

Skadden

1	Key Tax Incentives
2	Certain Eligibility Requirements
3	Common Eligibility Issues
4	Tax Equity Structures
5	Alternative Financing Possibilities

Overview

Skadden

- Due to the growing importance of renewable energy, there are numerous federal, state and local incentives available with respect to renewable energy projects
- Certain of these incentives are granted through the tax code, and may be utilized by owners and investors in these projects only to the extent they have tax capacity
  - Many developers of renewable energy projects do not have such tax capacity and therefore seek to monetize the tax benefits through equity investments by investors that do have tax capacity
  - Those investors include banks, insurance companies and other commercial enterprises that have invested equity in renewable energy projects with the potential to achieve attractive after-tax returns and, at the same time, garner accolades for "going green"
- Over the past few years, the White House and the Department of Energy have held summits encouraging U.S. corporations to invest in renewable energy projects and take advantage of these various incentives

1 Key Tax Incentives

Depreciation

Skadden

- *Accelerated Depreciation*. Taxpayers generally allowed to claim accelerated depreciation deductions over a 5-year recovery period with respect to the adjusted tax basis for certain renewable energy property (including wind and solar assets)
- *Bonus Depreciation.* Taxpayers generally allowed to claim a one-time depreciation deduction equal to 50% of the adjusted tax basis of certain renewable energy property placed in service before 2020 (subject to a phase-down beginning in 2018)
- *Capitalization of Depreciation*. Electricity is a "good" subject to the capitalization rules
  - Depreciation is included in the cost of goods sold and, thus, cannot be specially allocated through a partnership

Tax Credits

Skadden

- *Production Tax Credit ("PTC")*. Taxpayers permitted to claim PTCs based on the production and sale of electricity over a 10-year period for qualified facilities the construction of which begins before 2020 (for wind) or 2017 (for biomass, geothermal, hydropower, landfill gas, trash combustion, marine renewable and hydrokinetic facilities)
  - 2.3 cents/kWh in 2016 for wind, closed-loop biomass and geothermal
  - 1.2 cents/kWh in 2016 for open-loop biomass, hydropower, landfill gas, trash combustion, marine renewable and hydrokinetic
- *Election for Investment Tax Credit ("ITC") In Lieu of PTCs*. Taxpayers permitted to claim (in lieu of PTCs) an ITC for 30% of the adjusted tax basis of property that would otherwise be eligible for PTCs
- Phase-out for Wind Property:

If constructions begins in…	PTCs/ITC reduced by…
2017	20%
2018	40%
2019	60%

Tax Credits (cont'd)

Skadden

- *ITC for non-PTC Property*. Taxpayers permitted to claim an ITC equal to the applicable percentage of the adjusted tax basis of certain energy property, generally:
  - for solar property placed in service before 2024: 30% (if construction begins before 2020), 26% (if construction begins in 2020), and 22% (if construction begins in 2021)
  - 30% for qualified fuel cell (limited to $1,500 per 0.5 kW of capacity) or qualified small wind, in either case if placed in service before 2017
  - 10% for certain other energy property (including solar property if construction begins after 2021 or if placed in service after 2023)

Tax Credits – Comparison

Skadden

Incentive	Basis Reduction	Recapture Period	Reduction for Subsidies
PTCs	None	None	Reduced (up to 50%) by the percentage of capital financed by grants, tax-exempt bonds, subsidies and other credits
ITC	50% of credit	Five years	Generally, none

Tax Credits – Comparison (cont'd)

Skadden

Incentive	Key Advantages
PTCs	• Not subject to recapture • Transferable after project placed in service (i.e., investor not required to invest prior to placed in service date) • Frequently greater present value (e.g., wind projects with high capacity factors and low relative capital costs) • Depreciable tax basis not reduced by PTCs • Allows developers that are pass-through entities with tax-exempt investors (e.g., certain private equity funds) to monetize with tax equity investors
ITC	• More predictable than PTCs • Not subject to operational risk • Ability to utilize leasing structures for tax equity monetization

Tax Credits – Comparison (cont'd)

Skadden

Incentive	Key Disadvantages
PTCs	• Need long-term tax capacity to utilize • Subject to operational risk • Reduction for grants, tax-exempts bonds, subsidies and other federal income tax credits
ITC	• Need significant current year tax capacity to utilize • Subject to recapture • Generally not transferable once project placed in service (i.e., investor must invest prior to placed in service date) • Depreciable tax basis reduced by 50% of the ITC • Disallowed on a proportionate basis to the extent that the project is owned by a pass-through entity which has tax exempt investors

Tax Credits – Comparison (cont'd)

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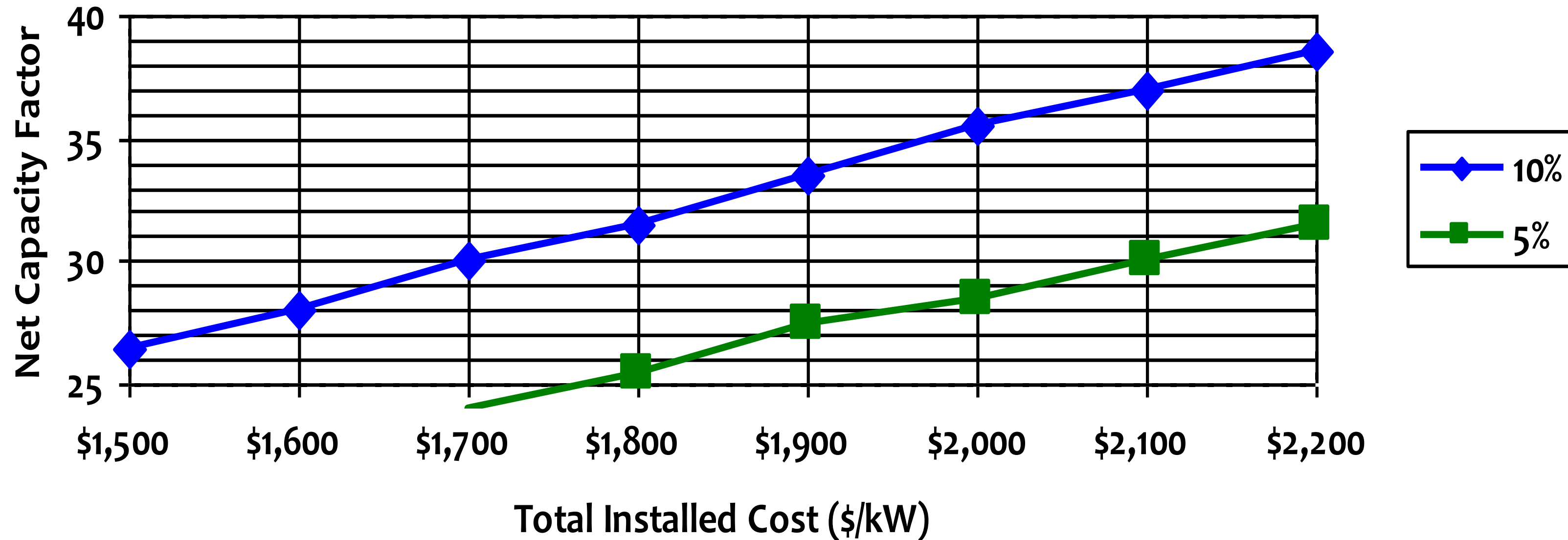


- PTCs are production-based, thus vary by capacity factor
- ITC is a fixed percentage of eligible capital cost
- PTCs are more valuable than ITCs for wind projects with higher capacity factors and lower capital costs (also depends on discount rate – see chart)

2 Certain Eligibility Requirements

Beginning of Construction Requirement

Skadden

- PTCs or an ITC is available only for projects that begin construction before the specified deadline
- The IRS has issued guidance for PTC-qualifying projects
- May demonstrate that construction has begun in one of two ways:
  - Subjective test: Begin physical work of a significant nature; or
  - Objective test: Meet a 5% safe harbor (or 3% safe harbor)
- On-site & off-site work may be taken into account
  - For example, off-site manufacture of components to be assembled on-site
  - Reasonable methods must be used to associate components with particular facilities
- Work performed by other persons under a written binding contract is considered
  - Written binding contract means:
    - » Enforceable under state law and does not limit damages to a specified amount (limitation equal to 5% or more of the contract price is permitted)
    - » Contracts providing full refund are not binding
    - » Conditions not within the control of either party are permitted
    - » Insubstantial changes or terms to be determined by standards not within the control of either party are permitted (e.g., minor modifications to design specifications)

Beginning of Construction Requirement (cont'd)

Skadden

- 5% Safe harbor—Incurred 5% or more of the total cost of the qualifying property
  - For accrual method taxpayers, costs are generally "incurred" when the following three are met with respect to the taxpayer's liability:
    - Fixed
      - Earlier of payment is due or the required performance has occurred
    - Determinable with reasonable accuracy
      - Calculation of the liability is known or knowable
    - Economic performance has occurred
      - Goods or services provided; or
      - Goods or services may be treated as provided when applicant pays for them, if reasonable expectation they will be provided within 3½ months of payment
  - All costs included in the eligible basis of the qualifying property (and only such costs) are taken into account
  - With respect to costs incurred by other persons under a written binding contract, only costs incurred by such other person are taken into account (i.e., their mark up or profit component is not included)
  - Continuous efforts to advance towards completion required
    - Disruptions for reasons beyond the taxpayer's control are permitted
    - Deemed satisfied if placed in service by the later of December 31, 2016, or four calendar years after the year in which construction began

Beginning of Construction Requirement (cont'd)

Skadden

- 3% Safe harbor—Incurred 3% or more of the total cost of the property or failed to meet 5% due to cost over runs
  - Same rules apply for determining costs incurred
  - Only available for multiple facilities operated as a single project
    - Single project factors: legal entity; contiguous land; PPA; intertie; substation; permits; construction contract; and loan
  - Proportionate eligibility: May claim ITC/PTCs for the number of facilities the cost of which does not exceed 20 times the costs incurred before the applicable deadline
  - May still satisfy the physical work test (allowing for full qualification)

Beginning of Construction Requirement (cont'd)

Skadden

- Begin physical work of a significant nature
  - Focus is on the nature of work performed, not the amount or cost
    - If work is significant in nature, there is no minimum amount, cost or percentage
  - Excludes preliminary work such as planning, design, preparing the land
  - Excludes work to produce property that is in existing inventory or normally held in inventory
  - With respect to property manufactured, constructed or produced pursuant to a written binding contract, only work performed after the contract is entered into counts
  - Continuous program of construction required
    - Disruptions for reasons beyond the taxpayer's control are permitted
    - Deemed satisfied if placed in service by the later of December 31, 2016, or four calendar years after the year in which construction began

Beginning of Construction Requirement (cont'd)

Skadden

- Transfers of a facility after construction began and before placed in service
  - Related Parties
    - Permitted (transferee gets credit for work performed or costs incurred by transferor)
    - Relatedness requires 20% ownership
  - Unrelated Parties
    - Permitted, if consists of more than just tangible personal property (or rights to acquire tangible personal property)

Placed in Service

Skadden

- Standards established in regulations, administrative guidance and case law
- Generally means ready and available for a specifically assigned function
- Five factor test for electric generating assets:
  - necessary permits and licenses obtained;
  - critical testing completed;
  - control of the facility;
  - synchronization with the transmission grid; and
  - daily or regular operations begun
- In the case of a new business, must also actually put the equipment to use in a trade or business
- IRS ruled that wind turbine generators (WTGs) capable of producing electricity at full capacity are placed in service despite the fact that taxpayer anticipates rotating the operation of the WTGs, with each WTG producing electricity at reduced capacity due to:
  - Temporary capacity limitations in the transmission provider's line due to its delays in completing transmission upgrades;
  - Temporary operation of taxpayer's substation and transmission system to accommodate such line limitations; and/or
  - Any curtailment by the power purchaser due to transmission congestion

3 Common Eligibility Issues

Power Purchase Agreements

Skadden

- An owner of a qualifying project is eligible to claim PTCs only if it produces and sells electricity from the project (except for certain biomass projects)
- An ITC is not available with respect to energy property if it is used by a disqualified person (e.g., tax-exempt organization or government)
- Section 7701(e) may, depending on the particular facts, recharacterize a service contract (e.g., a PPA) as a lease of the underlying property for tax purposes
- Section 7701(e)(3) provides a safe harbor for alternative energy facilities, unless the service recipient (or a related entity):
  - Operates the facility;
  - Bears any significant financial burden if there is nonperformance under the contract (other than for reasons beyond the control of the service provider);
  - Receives any significant financial benefit if the operating costs of such facility are less than the standards of performance or operation under the contract; or
  - Has an option or obligation to purchase all or part of the facility at a fixed and determinable price (other than at then fair market value)

Recapture Rules

Skadden

- Recapture period is the 5 years following the placed in service date
- Recapture amount is a percentage of the ITC
  - 100% on or prior to the 1st anniversary
  - 80% on or prior to the 2nd anniversary and after the 1st anniversary
  - 60% on or prior to the 3rd anniversary and after the 2nd anniversary
  - 40% on or prior to the 4th anniversary and after the 3rd anniversary
  - 20% on or prior to the 5th anniversary and after the 4th anniversary
- Recapture occurs if property is sold or otherwise disposed of within the recapture period
- Recapture occurs if any interest in any pass-through entity that directly or indirectly (other than through a taxable corporation) owns an interest in the eligible property is disposed of within the recapture period
- Recapture occurs if, within the recapture period, the property ceases to qualify as eligible property
  - Property will not cease to qualify as eligible property if the property's production of energy temporarily ceases and, at that time, the owner intends to resume production
  - Permanent cessation of energy production, however, will result in recapture

Codification of Economic Substance Doctrine

Skadden

- The economic substance doctrine is a U.S. tax law doctrine under which the tax benefits of a transaction may be denied if the transaction does not result in a meaningful change to the taxpayer's economic position other than a purported reduction in U.S. federal income tax liability
- Reconciliation Act of 2010 codified economic substance doctrine
- Conjunctive test—a transaction lacks economic substance unless (apart from federal income tax effects):
  - The transaction changes in a meaningful way the taxpayer's economic position; and
  - The taxpayer has a substantial purpose for entering into such transaction
- Strict liability penalty of 20% imposed
  - Increased to 40% if the relevant facts affecting the tax treatment are not adequately disclosed on the tax return

Codification of Economic Substance Doctrine (cont'd)

Skadden

- Determination of whether doctrine is relevant to a transaction is made in the same manner as under prior law
- Technical explanation prepared by the Joint Committee on Taxation states:
  - Tax credits should not be disallowed if they are consistent with the Congressional purpose or plan that the tax benefits were designed to effectuate
  - For example, a tax credit should not be disallowed when a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage
  - Note that JCT technical explanation generally does not constitute legislative history
- IRS Large Business & International Division Directive lists among factors indicating that application of the doctrine is likely not appropriate "the transaction generates targeted tax incentives, in form and substance, consistent with the congressional intent in providing the incentives"

Codification of Economic Substance Doctrine (cont'd)

Skadden

- In Sacks v. Commissioner (1995) the Ninth Circuit held that sale-leaseback transactions did not lack economic substance merely because the investor expected to realize a profit only after taking into account the federal income tax benefits
  - According to legislative history, Congress enacted the ITC as an inducement to invest in solar energy property because it recognized that such investments would not otherwise be made because of their anticipated low profitability
  - It would be incorrect to hold that an investment lacks economic substance merely because the investor is acting in accordance with Congressional intent
- Rev. Proc. 2007-65 defines investors as partners whose investment return is reasonably anticipated to be derived from both PTCs and operating cash flows
- Prior PLRs state that an investor does not expect to receive a positive cash-on-cash return, but a positive return taking into account the PTCs

Substance-Over-Form Doctrine

Skadden

- In Historic Boardwalk Hall, LLC v. Comm'r (2012) the Third Circuit assumed, without deciding, that a partnership transaction had economic substance but, nevertheless, denied an investor federal historic rehabilitation tax credits on the basis that the investor was not a "bona fide partner" for tax purposes because the investor lacked "meaningful downside risk" and "meaningful upside potential" necessary for an equity investment
  - "Meaningful downside risk"
    - "Investment Risk": The investor timed capital contributions to eliminate potential loss of capital
    - "Audit Risk": The developer indemnified the investor for potential loss of tax credits (plus penalties, interest, certain legal fees) due to IRS challenge
    - "Project Risk": The developer's other funding sources eliminated the investor's potential loss of tax credits due to failure to complete the project
    - The court also found the investor's 3% preferred return was "guaranteed" by put & call options; parties' agreement required developer to purchase GIC to cover its call
  - "Meaningful upside potential"
    - Despite investor's 99.9% interest in residual cash flow of partnership, the court found no expectation that the investor could share in any such cash flow due to financial forecasts of the partnership and the developer's call option
    - The court found the fair market value of the investor's interest would not exceed the investor's accrued but unpaid preferred return

Substance-Over-Form Doctrine (cont'd)

Skadden

- In Rev. Proc. 2014-12, the IRS provided a safe harbor for allocations of section 47 historic rehabilitation credits.
  - The safe harbor was in direct response to market reaction to the *Historic Boardwalk Hall* decision
  - The safe harbor only applies to the section 47 credit (not PTCs or ITCs)
- A key requirement of the safe harbor is that the investor's interest in the partnership must constitute a bona fide equity investment with a reasonably anticipated value commensurate with the investor's overall percentage interest in the partnership, separate from any federal, state, and local tax deductions, allowances, credits and other tax attributes to be allocated by the partnership to the investor
  - An investor's partnership interest is a bona fide equity investment only if that reasonably anticipated value is contingent upon the partnership's net income, gain and loss, and is not substantially fixed in amount
  - The investor must not be substantially protected from losses from the business
  - The investor must participate in profits in a manner that is not limited to a preferred return that is in the nature of a payment for capital

4 Tax Equity Structures

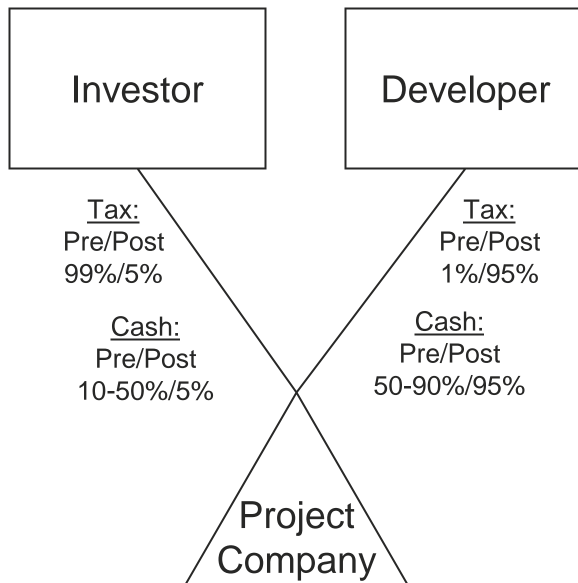
Overview

Skadden

- Federal incentives can amount to as much as 60% of the capital costs of renewable energy projects
- Many project developers either –
  - Do not have the federal tax base to efficiently absorb the tax benefits, or
  - Need to monetize the value of the tax benefits to finance the cost of developing the facility
- Thus, developers may seek to efficiently monetize the tax benefits and obtain capital at favorable equity rates
- The most common transaction structures are the partnership flip structure, the sale-leaseback structure, and the lease pass-through structure
  - Each can generally be accomplished on an unleveraged or leveraged basis
  - If debt financing is involved:
    - the investor may seek a higher investment return, due to additional debt-related risks; and
    - such risks may require a three-party negotiation (among the developer, the investor and the lender)

Partnership Flip Structure – Overview

Skadden



* Cash distribution percentages vary widely in transactions; these are for illustrative purposes only

- Pre-Flip Period
  - Developer receives 50-90% of cash distributions* and 1% of tax allocations
  - Investor receives 10-50% of cash distributions* and 99% tax allocations
- Post-Flip Period
  - Developer receives 95% of cash distributions and tax allocations
  - Investor receives 5% of cash distributions and tax allocations
- Flip occurs when investor achieves a specified after-tax IRR
  - A time-based flip is also possible
- Developer has option to purchase investor's interest post-flip at fair market value

Partnership Flip Structure – Considerations

Skadden

- **Advantages**
  - Widely used and accepted structure
  - Established administrative guidance regarding structure in context of wind projects (Rev. Proc. 2007-65)
  - Developer's repurchase option is less costly because investor's residual interest is only 5%
  - Available for the PTC or ITC
- **Disadvantages**
  - In case of ITC, investor must be in partnership before placed in service date
  - May require a greater up-front capital investment by developer than leasing structures
  - May result in uneven cash flows for developer and investor over time
  - If project performance exceeds expectations, flip is accelerated resulting in a majority of the remaining tax benefits being allocated to developer (some ability to manage this issue with additional contingent payments)
  - Complex partnership tax rules and financial accounting

Partnership Flip Structure – Allocations

Skadden

- Tax credits do not affect capital accounts and thus cannot have economic effect
- PTCs are allocated in the same proportion as “receipts” from the sales of electricity which gave rise to the PTCs
  - Therefore, PTCs follow the allocation of gross income for the sale of electricity
- ITC is allocated in the same proportion as the partners divide general profits of the partnership, regardless of whether the partnership has a profit or loss for the taxable year
  - Therefore, ITC generally follows the allocation of bottom line taxable income
- Recall: depreciation is included in the cost of goods sold and, thus, cannot be specially allocated

Partnership Flip Structure – Rev. Proc. 2007-65 Requirements

Skadden

- **Minimum Interests**
  - Developer must have, at all times, a minimum 1% interest in each material item of *income, gain, loss, deduction and credit*
  - Each investor must have, at all times, a minimum interest in each material item of *income and gain* equal to 5% of the investor's maximum interest in such items
- **Minimum Investment**
  - Each investor must maintain, at all times, an investment in the partnership equal to at least 20% of its "total capital contributions" (i.e., fixed capital contributions plus reasonably anticipated contingent capital contributions required to be made by the investor under the partnership's operating agreement)
    - However, minimum investment can be reduced as a result of distributions of operating cash flows from the partnership
  - No investor may be protected by any person related to the partnership against loss of any portion of its minimum investment
  - At least 75% of each investor's total capital contributions must be fixed (i.e., not contingent in amount or certainty of payment)

Partnership Flip Structure – Rev. Proc. 2007-65 Requirements (cont'd)

Skadden

- Limitations on Purchase and Sale Rights
  - Purchase Rights
    - Neither developer nor any investor (nor any related party) may have a right to purchase, at any time, the wind farm, any property included in the wind farm or an interest in the partnership for less than fair market value
      - Fixed price purchase option that is a reasonable estimation of then fair market value may be permissible
    - Developer may not have a right to purchase the wind farm or an interest in the partnership earlier than 5 years after the wind farm is first placed in service
      - Note, however, that Rev. Proc. 2014-12 (for rehab credit projects) prohibits call rights by developer, but permits put rights by investor
  - Sale Rights
    - The partnership may not have a right to cause any party to purchase the wind farm or any property included in the wind farm (other than electricity)
    - No investor may have a put right with respect to its interest in the partnership
      - Note, however, that Rev. Proc. 2014-12 (for rehab credit projects) permits put rights by investor, but prohibits call rights by developer

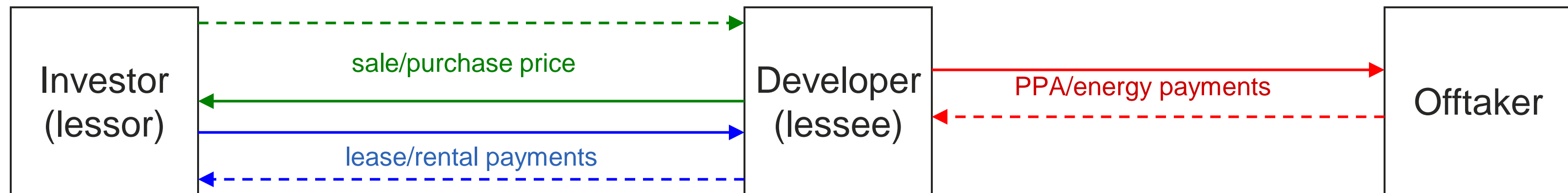
Partnership Flip Structure – Rev. Proc. 2007-65 Requirements (cont'd)

Skadden

- Limitations on Guarantees and Loans
  - No person may guarantee or otherwise insure an investor's right to any allocation of tax credits
  - The partnership must bear the risk that the available wind resource is not as great as anticipated or projected
    - However, a third party may guarantee wind resource availability if the partnership or an investor pays the cost of or premium for such guarantee
    - For example, a weather derivative contract between the partnership and an insurance company is acceptable
  - Rev. Proc. 2014-12 requires that any guarantees must be unfunded
    - No money or property set aside, no reserves (exception for reasonable 12 month operating expenses) and no minimum net worth requirements
  - Neither developer nor any party related to developer may lend any investor funds to acquire an interest in the partnership or guarantee any debt incurred or created in connection with the acquisition

Sale-Leaseback Structure

Skadden



- Project is sold by developer to investor and then leased back to developer
  - Developer delivers power to offtaker via a power purchase agreement ("PPA")
- Investor as owner/lessor claims:
  - ITC; and
  - tax depreciation
- Developer as lessee retains option to purchase the project at the end of the lease term at fair market value

Sale-Leaseback Structure – Considerations

Skadden

- Advantages
  - Structure can be implemented up to 3 months after placed in service date
  - Can provide up to 100% financing to developer
  - Developer retains upside if project performance exceeds expectations because rent payments are fixed
  - May require fewer regulatory approvals for an investor that is a bank as compared to the partnership flip structure
- Disadvantages
  - Developer's purchase option is more expensive because investor owns the entire project at the end of the lease and residual value must be at least 20% of original value
  - Not available with respect to projects claiming PTCs (except for certain biomass projects)
  - Financial accounting subject to change
- Key Consideration
  - Structure must satisfy requirements to be respected as a true lease for U.S. federal tax purposes
    - IRS leveraged lease guidelines (see next slide)
    - Case law

Sale-Leaseback Structure – Rev. Proc. 2001-28 Requirements

Skadden

- Rev. Proc. 2001-28 sets forth the IRS ruling guidelines with respect to leveraged leasing transactions
  - Lessor must have and maintain a minimum investment of at least 20%
  - Residual value must be at least 20% of original value
  - Lease cannot exceed 80% of the useful life of the property
  - Lessee and its affiliates cannot have a call option for a price less than fair market value
  - Lessor cannot have a put option
  - Lessee generally cannot pay for unseverable improvements unless legally required
  - Lessee cannot provide loans to lessor or guarantee lessor loans
  - Lessor must expect a pre-tax profit

Pass-through Lease Structure

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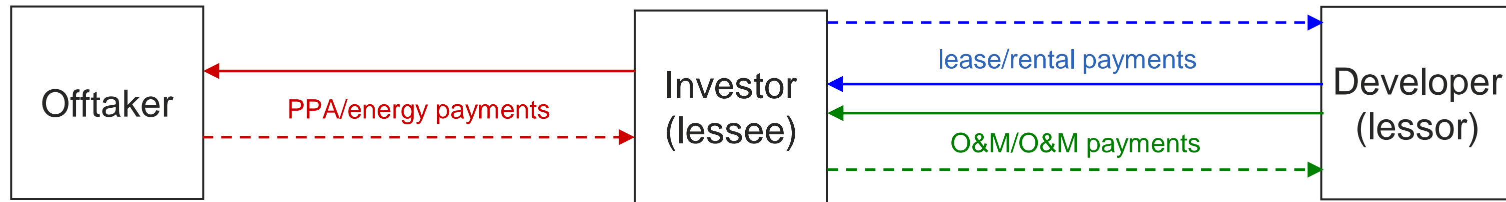

- Project is leased by developer to investor and developer makes election to allow lessee to claim the ITC
  - Lease may be prepaid or monetized by financing lease stream
  - Developer operates the project on behalf of investor pursuant to an operation & maintenance agreement ("O&M")
  - Investor delivers power to offtaker via PPA
- Developer as owner/lessor claims tax depreciation
- Investor as lessee claims tax deductions for rental payments in lieu of tax depreciation
- Developer as lessor receives rental payments from the investor (as lessee) and shelters taxes on the rental income through losses generated by the depreciation
- Project automatically reverts to developer at the end of the lease term

Pass-through Lease Structure – Considerations

Skadden

- Advantages
  - Investor has no residual interest
  - Allows for bifurcation of depreciation from ITC
  - Developer may be able to retain some upside if project performance exceeds expectations through bonus payments under O&M
  - May require fewer regulatory approvals for an investor that is a bank as compared to the partnership flip structure
- Disadvantages
  - Not available with respect to projects claiming PTCs (except for certain biomass projects)
  - Investor recognizes income over 5 years in an amount equal to 50% of the ITC
- Key Consideration
  - Structure must satisfy requirements to be respected as a true lease for U.S. federal tax purposes
    - IRS leveraged lease guidelines (see slide 37)
    - Case law

5 Alternative Financing Possibilities

Possible Alternative Capital Sources

Skadden

- Real Estate Investment Trusts ("REITs") can be thought of as a mutual fund for real estate
  - A REIT can own the REITable assets and lease them to the generator
  - A REIT can loan money against any REITable assets owned by the generator
- May provide access to certain investor groups who do not currently participate in renewable energy projects (i.e., tax exempt, U.S. retail, foreign portfolio)
- The assets of a renewable energy project fall into three buckets
  - REITable – transformers, gathering lines, substations, interconnect, land, etc.
  - Potentially REITable – towers, pads, mounting systems, etc.
  - Non-REITable – turbines, blades, panels, etc.
- Unfortunately, ownership by a REIT can reduce or eliminate the available tax incentives
  - PTCs – taxpayer generally must own and operate the "qualified facility" which, in the case of a wind farm, the IRS has said includes the towers and pads
  - ITC – assets owned by a REIT generally not eligible

Possible Alternative Capital Sources (cont’d)

Skadden

- Master limited partnerships (“MLPs”)
  - No corporate-level tax on MLP-level income
  - Much more flexible than REITs
  - Less tax-friendly for certain types of tax-exempt, foreign and U.S. investors
  - Can own assets and lease them to an operator
  - From a tax perspective, much easier to run an independent power generation business through an MLP than a REIT
- Up-Cs / YieldCos
  - More flexible than either a REIT or an MLP—no tax requirements related to assets or operations
  - Income subject to corporate-level income tax
  - Use of renewable energy tax incentives to manage corporate-level income taxes

Possible Legislative Developments

Skadden

- Extension of PTC and/or ITC
- Refundable ITC
- Extension of Bonus Depreciation (including 100%)
- Master Limited Partnership Legislation
- Cap and Trade or Other Carbon Controls
- Federal Renewable Portfolio Standard