

# Tax Update

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**The economic stimulus bill last February took two steps to try to keep renewable energy development on track. First, it directed the US Treasury to pay owners of new renewable energy projects completed in 2009 or 2010 — or that start construction in 2009 or 2010 and are completed by a deadline — 30% of the project cost in cash. The payments will be made 60 days after a project is placed in service or, if later, 60 days after the Treasury receives a complete application. They are also available on some cogeneration facilities.**

**The Treasury received 219 applications through September 11 and it has approved payments of \$827.8 million to date on 26 projects. Of the 219 applications, 161 are for projects that are already in service. The other 58 are for projects that are merely under construction. Treasury had hoped to announce \$1 billion in grants approved by late August. It is taking out the largest applications to review first.**

**8 rejected**

**28 have issues**

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**Construction starts when “physical work of a significant nature” commences at the site or when more than 5% of the total project cost has been incurred. Physical work of a significant nature at the site starts with “excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of concrete pads for the foundation.”**

**Costs are not considered “incurred” for purposes of the 5% test until there is “economic performance.” There is some uncertainty about whether work counts if it is off site. An example is assembly of specially-ordered solar panels or wind turbines at the factory.**

**expected cost?**

**Developers who raised money from private equity funds may be out of luck. No cash grant will be paid on any project that is owned by a partnership or other passthrough entity in which a government agency or instrumentality, entity exempted from taxes under section 501(c), electric cooperative or Indian tribe owns an interest. Even a 0.1% interest owned four tiers up the ownership chain is enough to disqualify the project.**

**section 1603(g)**

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**The Treasury views the provision as a “nuclear bomb when a firecracker would do,” and it helped as much as it could in guidance on July 9. The project will qualify if the disqualified investors are on the other side of a blocker corporation. The blocker must be in place before the grant application is filed. The blocker will not be treated as disqualified even if it is majority owned by disqualified investors.**

**Congress is expected to make a technical correction. The scope is still under discussion. At a minimum, the correction will make clear that investors who pay taxes on their earnings from a project as “unrelated business taxable income” will not be treated as disqualified.**

**partial downstream blockers?  
proportionate disallowance?**

**Many developers are talking to banks about lending construction debt in two tranches. One tranche would be secured by the cash grant and bear a lower interest rate. The remaining debt would convert to term debt. Banks were concerned that foreclosing on a project during the first five years after it is completed would trigger recapture of the cash grant. The Treasury said in July that the government will ask for the grant back only in three narrow circumstances.**

**change in use**

**permanent shutdown**

**transfer to disqualified owner**

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**There is no dollar limit on the amount of cash grants. The renewable energy trade associations are already beginning to talk to Congress about extending the program. The growing concern in Washington about the federal budget deficit will make this challenging. However, the Joint Tax Committee estimated the original program will cost the government only \$5 million.**

**feed-in tariff**

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**The Treasury grants do not have to be reported as income at the federal level. Some states, including California, are considering whether to tax them at the state level.**

**conformity  
minimum taxes**

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**Congress authorized the US Department of Energy in the stimulus to guarantee lenders to renewable energy projects that the debt would be repaid. DOE has authority to guarantee up to 80% of project cost in debt, but is expected stop short of guaranteeing the full debt. Rules for the new loan guarantee program are expected out in the next few weeks. Projects must be under construction by September 2011 to qualify. The guarantees are for new debt and not for refinancing.**

**4 to 6 months**

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**Guaranteed debt is expected to price at 80 to 200 bps above comparable Treasury bonds. However, projects that involve innovative technologies can borrow through the Federal Financing Bank at 22 or 25 bps above comparable Treasuries.**

**At least four large wind tax equity deals structured as partnership flips have closed since the Treasury issued guidance about the cash grant program on July 9. A fifth deal is expected to close in late September. Yields have run from 7.5% to 14.25%. Tax equity has been used to bridge the Treasury cash grant and, with the grant, covers a little under 50% of the capital cost of the project.**

**Developers want to calculate the Treasury cash grant on the fair market value of the project rather than the construction cost. This happens if the project is sold and leased back. It is harder to do in a partnership flip transaction. Some developers are using “shifting partnerships.”**

**20% v 50% overlap**

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**Solar companies have been enamored with an inverted lease structure. Think of a yo-yo. The developer leases the project to a tax equity investor and elects to pass through the Treasury cash grant. At the end of a lease of 6 to 10 years, the developer takes the project back. The lessee sells the electricity and pays 98% of the revenue to the developer as rent. It also also pays \$1.21 to \$1.40 per dollar of cash grant to buy into the deal.**

**structural risk  
basis step up**

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**Prepaid service contracts are seeing heavier use in the municipal utility market. A municipal utility or cooperative prepays for a large share of the electricity to be supplied over the contract term in exchange for a discount. It pays currently for any excess electricity and for RECs. Some operating costs may be passed through under the contract. The prepayment covers a little less than 50% of the project cost and is like debt that is repaid in kind with electricity.**

**deferred income  
four “foot faults”**

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**Eighteen banks, investment banks and insurance companies supplied tax equity to renewable energy projects in the two years before the market collapsed last fall. Only four or five were still active after the stimulus passed. At least three more have returned, but a number of new investors have also appeared.**

**3/5 v 3/8**

**IRS guidelines**

**utilities**

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**The IRS proposed a new definition this week of what qualifies as a “waste” fuel. Residual matter must be less than 5% of the total material used and must be worth less than any product.**

**open-loop biomass?**

**Nevada is expecting a private ruling soon from the IRS that a non-profit corporation it plans to establish — called the Nevada Energy Assistance Corporation — to help build new transmission lines to serve renewable energy projects will be exempted from income taxes. The state has identified 14 potential transmission lines it wants to build. The ruling would let it finance the lines with tax-exempt debt.**

**higher cash flows**

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**A Duke university study last month called attention again to a private ruling the IRS issued in 2007 that said transmission lines are real property for tax purposes. This opened the door to use of REITs or MLPs to own transmission lines. Use of these vehicles would allow equity to be raised more cheaply.**

**no corporate tax**

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**Textron lost a key case in a federal appeals court in July. At issue is whether the IRS can have access to audit workpapers that Textron gave Ernst & Young to support calculation of the company's tax reserves on its financial statements. The court said the papers were not protected by attorney-client or work product privileges. Corporations are required to disclose uncertain tax positions on their financial statements. The court said the papers were not prepared in anticipation of litigation but rather in the ordinary course of business. The case is expected to go to the US Supreme Court.**

**SILO**

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**Build America Bonds have been a hit with state and local governments. A total of \$9.5 billion in 36 bond offerings were issued through May 20 when a Congressional subcommittee held a hearing. A California issue of \$5.25 billion on April 22 was oversubscribed by about \$16 billion. The bonds are taxable bonds, but the state or local issuer receives cash payments from the US Treasury for 35% of the interest on the bonds. They appeal to a larger potential market of pension funds and foreign investors.**

**credits stripped**

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**The pendulum may be swinging back to treating government payments to corporations as tax free. The IRS said in a private ruling in late July that money a hotel company was paid by a state to contribute to the cost of a new resort did not have to be reported as income. The state borrowed against future property and occupancy taxes and then turned the money over to the hotel company.**

**bioenergy payments**

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## Least reassuring headline:

# Most Deposits Safe Despite FDIC Fund's Shrinkage

BY JEFF D. OPDYKE

News Thursday that the federal fund protecting bank deposits has shrunk shouldn't scare bank customers, but it is a reminder to manage accounts diligently.

The balance in the Federal Deposit Insurance Corp.'s deposit-insurance fund has fallen to \$10.4 billion as of June, down from more than \$45 billion from a year ago. The agency now has 416 banks on its "problem" list, up from 305 at the end of March. Already this year, the FDIC has closed 81 banks.

Even with the deposit-insurance fund at relatively low levels, "there are no concerns about the safety of depositors' principal" under the FDIC insurance limit, said Greg McBride, senior financial analyst at Bankrate.com. The FDIC may ultimately impose special fees on banks to get more cash into the fund, which could hamper bank lending and leave them stingier on deposit rates. But, Mr. McBride said, depositors shouldn't worry about the safety of their funds.

Though consumers often worry that bank failures will tie up their deposits, bank accounts generally remain liquid even after the FDIC intervenes at an ailing institution. That is true whether the FDIC arranges for a

troubled bank to be bought quickly, as it did when pairing failed Colonial Bank with BB&T Corp. recently, or whether a bank goes into receivership, as did the recently failed Community Bank of Nevada.

"From a depositor perspective, it's all seamless, more like a bank merger than a failure," says Mr. McBride.

The key question is whether balances exceed deposit-insurance limits.

Congress last fall authorized the FDIC to temporarily increase deposit insurance to \$250,000 per person, per account, up from the longstanding \$100,000. Lawmakers recently extended the higher coverage to 2013. So, to ensure complete liquidity, an account holder should stay below the \$250,000 cap at any one bank.

Any amount above that is at risk. When a bank fails, the FDIC sells whatever assets exist and splits the funds among the bank's creditors, including account holders whose deposits topped the FDIC limit. Historically, those account holders have recovered about 72 cents on the dollar, said David Barr, an FDIC spokesman, though that has dipped to as low as about 40 cents.

Bank accounts also should be structured to ensure the great-



The FDIC estimated that the May failure of Florida-based BankUnited would cost its insurance fund \$4.9 billion.

est possible coverage. A joint savings account, for instance, provides protection up to \$500,000, since two people share the account. By sharing some accounts jointly and titling others individually, a couple could protect up to \$1 million in checking and savings accounts and CDs.

But beware: The FDIC considers "joint" to mean equal access by any person listed on the account. If an account is shared with a minor child who requires an adult's signature to access the money, the FDIC doesn't con-

sider that "equal access," Mr. Barr said.

Such an account's entire balance would fall under the parent's total insurance coverage, potentially pushing the cumulative amount above FDIC limits. The site [myFDICinsurance.gov](http://myFDICinsurance.gov) has an estimator that helps determine whether deposits exceed FDIC limits.

Pay attention, as well, to brokered CDs—higher-yielding, large-denomination CDs banks sell to brokerage firms, which in turn sell them to clients in

smaller pieces. These are generally FDIC-insured, but if such a CD is from a bank where other accounts are held, it could put total holdings there above the insured limit. The broker can clarify which bank the CD comes from.

If a CD pays rates well above the market, however, the FDIC or an acquiring bank has the right to cancel that contract or revise the rates downward—though in its purchase of troubled Washington Mutual, J.P. Morgan Chase & Co. honored well-above-market rates of 5% for one-year CDs.

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**Chance that a household that owns a Prius  
also owns an SUV:**

**1 in 3**

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**Estimated number of US adults who believe  
the media did not adequately cover Michael  
Jackson's death:**

**6.5 million**

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