



Community Wind Toolbox



This chapter is part of **Windustry's Community Wind Toolbox** which is designed to guide you through various aspects of developing a commercial-scale community wind project. Each section gives you background information about particular steps in project development and provides you with resources to help you to do more in-depth research on your own.

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Chapter 10: Tax Incentives

In order to be financially competitive, most wind projects need to take advantage of federal and, where available, state tax incentives. It is critical to understand the role and mechanics of tax incentives while developing a commercial-scale community wind project because these incentives can represent one-half to two-thirds of the total revenue stream over the first 10 years of operation due to the Federal Production Tax Credit (PTC) and Modified Accelerated Cost-Recovery System (MACRS) or other type of depreciation that can be applied to wind energy assets. *You will need to consult a tax professional in the early stages of project planning to ensure that your financial projections are valid and accurately take into account the project's tax burden and benefits.*

Different tax incentives apply to different projects based on location, project size, and other tax liability delimiters, so you will need to explore what is currently available and applicable to your project.

This section of the Toolbox provides information on currently available (as of spring 2007) tax incentives that have significantly contributed to wind energy development. It also explains mechanisms for utilizing them to improve your project's bottom line. The application of many of these tax benefits is also outlined in the **Business Models**, **Financing**, and **Project Calculator** sections of the Community Wind Toolbox. The role of the tax consultant is covered in further detail in the **Project Management** section.

Federal Tax Incentives

State Level Tax Incentives

Taxation of Wind Energy Property

Additional Resources for Taxes and other Incentives

Key to Toolbox icons:



Best Practices



Caution



Links to more information



Information that will affect your project's bottom line



Example

Federal Tax Incentives

The Federal Production Tax Credit

The Federal Production Tax Credit (PTC) is a 1.9¢/kWh credit (adjusted annually for inflation) that projects can earn during the first ten years of production. This credit, found in section 45 of the IRS tax code, has been the single largest driver of wind energy development in the United States to date, despite its continual need for renewal by Congress. Currently, the PTC is extended through the end of 2008, and advocates are pushing for further extension.

In order to qualify, an individual taxpayer must own the wind project and either materially participate¹ in the project or have tax liability from passive income that the PTCs can be credited against.² For individuals who do not materially participate, they must receive enough passive income (such as rental income or income from businesses in which they participate only as an investor) to produce a tax liability against which the credit can be applied.

Fully utilizing the PTC is a difficult hurdle for most farmers.³ If a farmer, rancher, or landowner does not materially participate in a wind project, the credits cannot be applied against the farmer's income from active farming businesses, wage income, or interest and dividend income. Even when a farmer materially participates, the value of the tax credit usually exceeds an individual's tax

liability from the wind project plus any other sources.

Community wind developers need to be aware that the PTC amount for an individual project may be reduced by the use of other federal or state funding, such as U.S. Department of Agriculture Farm Bill grants. For example: if your community project receives a 25% USDA grant to help with project costs, the project will be eligible for only 75% of the PTC.

Wind energy is where we need to go – it's good for the environment and builds American energy independence and American industry. Our family-owned business can work profitably in wind power.

Gary Stoks
CEO, SMI Hydraulics
Porter, MN

AT-A-GLANCE

Passive Tax Appetite

Income from certain types of investments, such as rental activities or business and trade activities that you do not materially participate in, qualifies as passive income. Tax paid on this income is considered passive tax. To take advantage of the Federal Production Tax Credit (the PTC), you or a project partner must be paying taxes that fit into this category of tax liability if you are an investor in the project but do not materially participate in its operation.

i For more information on PTC utilization and its interaction with other incentives see:

"Avoiding the Haircut: Potential Ways to Enhance the Value of the USDA's Section 9006 Program" written by Mark Bolinger of Lawrence Berkeley National Laboratory:

<http://eetd.lbl.gov/ea/ems/reports/61076.pdf>

"Publication 925: Passive Activity and At-Risk Rules" a publication by the Department of Treasury – Internal Revenue Service:

<http://www.irs.gov/publications/p925/ar02.html>

PTC & the "Flip". Many locally owned, for-profit entities are eligible for the PTC, but their modest tax appetites limit the amount of the tax credit they can utilize. The "Minnesota Flip" is a business model designed to help local wind project owners with minimal tax credit appetite pair up with a larger entity that has a more substantial tax burden. Because the tax credits available to project owners are typically proportional to their level of ownership in the project, the tax-motivated entity is the majority owner in the first ten years of production and often pays a "management fee" to the local owner in lieu of power sales revenue. Once the tax incentive period ends after year 10, the majority ownership of the project "flips" to the local owner, and the tax-motivated investor takes a minority share in the project. For more information, see the **The Minnesota Flip** section of the Toolbox.

¹ See Internal Revenue Service Publication 925.

² United States Government Accountability Office, Renewable Energy: Wind Power's Contribution to Electric Power Generation and Impact on Farms and Rural Communities, 42 (September 2004), available at: <http://www.gao.gov/new.items/d04756.pdf>.

³ GAO, 41.

Clean Renewable Energy Bonds (CREBs)

Clean Renewable Energy Bonds are available to entities that are not eligible for the PTC due to their non-taxable status, including state and local governments, municipalities, rural electric cooperatives, Native American tribal governments, and public and private non-profit organizations to finance renewable energy projects. After the bonds are issued, their interest is paid by the federal government in the form of tax credits, creating an interest-free source of financing. The IRS received over \$2 billion in applications for the initial \$800 million available, which led to the expansion of the program to an additional \$400 million for 2007. With the popularity of the program there are serious discussions about expanding the program to include more allocations in the future for more than one funding cycle at a time.

 For more information on CREBs visit:
www.windustry.org/community/crebs.htm

Modified Accelerated Cost-Recovery System (MACRS or Accelerated Depreciation)

With accelerated depreciation, wind projects can write off the value of their equipment on their financial balance sheets over 5 years rather than the typical 20-year projected lifetime of a project. While accelerated depreciation is available to all wind energy projects, the level at which a project can take advantage of this program is, like the PTC, limited to the project owners' applicable tax burden. Community wind project owners that typically have a small tax burden may not be able to take advantage of accelerated depreciation without taking on a tax-motivated investor with a sufficient tax appetite to claim the entire incentive.

Alternative Minimum Tax

 *The Alternative Minimum Tax (AMT) is confounding for many Americans who find themselves suddenly beholden to the IRS for taxes they thought they didn't owe. AMT can be thought of as a different tax system with different rules and deductions; taxpayers must compute their taxes under both the regular tax and AMT rules and then pay the greater of the two.*

The purpose of the AMT is to prevent those in the highest tax bracket from getting by from year to year tax free. A consequence is that many unsuspecting taxpayers who make

EXAMPLE

Modified Accelerated Cost Recovery System

The depreciation of wind projects is based on a table which calculates the depreciation of wind energy assets taken at the midpoint of the calendar year. This causes the five year accelerated depreciation to actually continue into year six.

For a \$10 million wind energy investment, the balance sheet loss due to depreciation in years one through six becomes:

Year	Depreciation	Year-end Value	% Depreciation of Initial Assessed Value
1	\$2,000,000	\$8,000,000	20%
2	\$3,200,000	\$4,800,000	32%
3	\$1,192,000	\$2,880,000	19.2%
4	\$1,152,000	\$1,728,000	11.52%
5	\$1,152,000	\$576,000	11.52%
6	\$576,000	\$0	5.76%

This is a simplified example to give a flavor of the benefits possible if you are able to structure it to efficiently capture tax incentives. It should not be used to make financial projections. Like any large investment, you should consult a tax professional with experience in corporate tax law to accurately develop your assumptions.

For more information, see:

<http://www.dsireusa.org/documents/Incentives/US06F.htm>

less than \$100,000 a year with certain kinds of investments and deductions end up having to pay AMT. Investing in certain types of businesses can trigger the AMT.

The only way to determine if your investment in a wind project will trigger the AMT is to work with a tax professional to fill out IRS Form 6251. If it turns out that your AMT is higher than what you would pay normally, then your investment in a wind project will limit your ability to utilize the PTC and other tax credits available to wind energy investors. Form 6251 can be found on the IRS's website by searching for the form by number: www.irs.gov.

State Level Tax Incentives

Production Tax Credits

In 2005, the state of Iowa instituted both a corporate and individual income tax credit for wind energy projects. Sections 476C (individual) and 476B (corporate) afford for a 1.5 cent/kWh and a 1.0 cent/kWh production credit respectively for qualifying projects with the idea that projects that were owned by Iowa individuals and businesses could compete with wind projects that could more easily capture the PTC. These sections of the tax code authorized 90 MW (476C) and 450 MW (476B) of wind projects to receive the payments.

To qualify for the personal tax credit the wind energy facility must be at least 51% owned by qualifying Iowa entities as defined in the statute. To qualify for the corporate tax credit the project must only be approved by the Iowa Utility Board.

Two months after the credit was created the allocations were completely filled up with waiting lists of projects.*

Sales Tax Exemption

Several states have exempted sales tax on equipment, infrastructure, supplies and replacement parts for wind systems.

i To see if your state has an exemption on sales tax on wind energy systems visit the Database of State Incentives for Renewable Energy: www.dsireusa.org.

Taxation of wind energy property

Property Taxes and Payments-In-Lieu-of-Taxes (PILOT).

Several states and localities have exempted renewable energy systems from property tax in order to promote development. This has a favorable impact on the economics of a project because the addition of a several million dollar wind project to a parcel of land could send the assessed property value through the roof, greatly increasing the tax burden to the landowner or project developer.

Many communities in areas where wind development is prevalent and renewable energy systems are exempt from property taxes negotiate payments (PILOTs) between the local taxing authority and the project. These payments compensate for excessive use of infrastructure in the area while developing the project and

allow the local community to benefit from wind energy development. Property taxes and PILOTs contribute a great deal to the tax revenue of many windy rural areas and aid in the development of new schools, community centers, and other local programs. Project developers opt to enter into PILOT contracts in order to be good neighbors to the community, while other areas may require these payments before local authorities grant permission to build.

The New York State Energy Research & Development Authority (NYSERDA) has developed detailed information on property tax exemptions and payments-in-lieu-of-taxes as part of their Wind Energy Tool Kit. Much of the information is specific to the state of New York, but the descriptions of the different types of payments may be transferable to other parts of the country.

i For more information, see: http://www.powernaturally.org/Programs/Wind/toolkit/19_propertytaxexemptions.pdf.

Taxation based on production. Some states tax energy facilities based on the energy produced. Minnesota, for example, has a tiered tax structure on energy production. The tax rate is determined by the size of the project.

- *Large-Scale Wind Energy Conversion Systems:* Projects with installed capacities of 12 MW or greater will make payments of 0.12¢/kWh.
- *Medium-Scale Wind Energy Conversion Systems:* Projects with installed capacities between 2 and 12 MW will make payments of 0.036¢/kWh.
- *Small-Scale Wind Energy Conversion Systems:* Projects with installed capacities between 250 kW and 2 MW will make payments of 0.012¢/kWh.
- Systems with installed capacities less than 250 kW are exempt from the production tax.

The tax structure was set up this way to level the tax playing field between small projects and large projects, as well as to promote smaller locally-owned projects by not placing undue burden on them. It is important to consult with the local tax authority to determine how the project will be taxed.

i More information on taxation of wind energy facilities in Minnesota: <http://www.windustry.org/resources/tax.htm>

* For more information about Iowa Renewable Energy Production Tax Credits visit the Database of State Incentives for Renewable Energy's page on Iowa Incentives for Renewables and Efficiency: www.dsireusa.org

Additional Resources for Taxes and other Incentives

Database of State Incentives for Renewable Energy (DSIRE)

DSIRE is a comprehensive source of information on state, local, utility, and federal regulations and incentives that promote renewable energy and energy efficiency.

www.dsireusa.org

National Renewable Energy Laboratory

"Avoiding the Haircut: Potential Ways to Enhance the Value of the USDA's Section 9006 Program." Prepared by Mark Bolinger of Lawrence Berkeley National Laboratory to address concerns regarding the interaction between the USDA Farm Bill and the federal Production Tax Credits for wind energy projects.

<http://eetd.lbl.gov/ea/ems/reports/61076.pdf>

Energy Trust of Oregon

"A Comparative Analysis of Community Wind Power Development Options in Oregon," by Mark Bolinger, Ryan Wiser, Tom Wind, Dan Juhl, and Robert Grace, published August 2004. An examination of potential community wind project ownership structures in the Northwest and the types of support needed to make them viable.

www.energytrust.org/RR/wind/OR_Community_Wind_Report.pdf

A version of this report was adapted for applicability beyond Oregon by Mark Bolinger for Lawrence Berkeley National Laboratory in November 2004.

<http://www-library.lbl.gov/docs/LBNL/567/03/PDF/LBNL-56703.pdf>

Internal Revenue Service

Look up information on various tax codes, forms, and agencies to contact for tax advice:

www.irs.gov