

News from our Clean Technologies Group

Guidance Released on Wind Energy Partnerships

IRS Announcement 2009-69

On September 21, 2009, the Internal Revenue Service issued new guidance on wind energy partnerships and the production tax credit under Section 45 of the Internal Revenue Code (“IRC”): www.cooley.com/files/IRS_Announcement2009-69-WindEnergyPartnerships.pdf

Background

IRC Section 45 provides for a tax credit based on the amount of electricity produced from wind and other qualifying renewable energy sources and sold to unrelated parties during the taxable year. The amount of the credit is adjusted annually for inflation. In the case of wind energy property, the credit for 2009 is equal to 2.1 cents per kilowatt hour of electricity sold to unrelated parties during the year. Credits are available for electricity produced during the ten-year period after the wind energy property is placed in service.

In 2007, the IRS issued Rev. Proc. 2007-65, which provides a safe harbor for the allocation of Section 45 credits by wind energy partnerships. If a partnership satisfies the requirements of the safe harbor, the IRS generally will not challenge the partnership’s allocation of Section 45 tax credits among its partners.

Wind energy partnerships typically have as partners a developer and one or more investors. The investors are often allocated a relatively high percentage of the partnership’s tax items (including tax credits and depreciation deductions) during an initial period, after which the investors’ interests

in the partnership are substantially reduced. (This reduction is referred to as a “flip.”) It is common for the developer to have the option to buy the investors out after the flip. However, the Rev. Proc. 2007-65 safe harbor imposed numerous restrictions on purchase options in the context of wind energy partnerships. One such restriction was that neither the developer, an investor, nor a related party was permitted to have the right to purchase an interest in the wind partnership or in the underlying wind energy equipment for a price other than fair market value determined at the time of the exercise of the right.

Guidance released

On September 21, 2009, the IRS issued Announcement 2009-69 (the “Announcement”), which amends Rev. Proc. 2007-65, altering the terms of the safe harbor for wind energy partnerships.

Most significantly, the Announcement loosens the restrictions on rights to acquire interests in the wind partnership or the underlying wind energy equipment. The Announcement permits a purchase option that is based on an exercise price fixed in advance, provided that (i) the option is negotiated for valid non-tax business reasons at arm’s length by parties with material adverse interests and (ii) the parties reasonably believe, based on all facts and circumstances at the time the exercise price is determined, that the price will not be less than the fair market value of the property at the time that the option may be exercised. Thus, the partners now have the option of fixing the exercise price for

a purchase option in advance. However, we recommend that partnerships using the fixed-price option prepare documentation (at the time the option is granted) establishing that the partners reasonably believed that the price under the purchase option would not be less than the fair market value of the underlying property at the time of exercise.

The Announcement retains the safe harbor requirement that neither the developer nor

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a related party may have an option that is exercisable within five years of the date the project is placed in service.

The Announcement also suggests that the IRS may now apply a less rigorous standard of review to tax returns for wind energy partnerships that do not meet the requirements of the safe harbor. Finally, the Announcement clarifies that partners who are subject to the passive activity rules (generally, individuals, estates, trusts, and closely held corporations) can use passive activity credits from qualified wind facilities to offset their tax liability from any passive activities (rather than from qualified wind facilities only). ■

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