The Effect of NYSERDA's Wind Project Assistance on the Federal Production Tax Credit

March 2002

Prepared for

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THE EFFECT OF NYSERDA'S WIND PROJECT ASSISTANCE
ON THE FEDERAL PRODUCTION TAX CREDIT

I. ISSUE.

What impact does NYSERDA project funds have on the section 45 renewable electricity production tax credit?

II. SUMMARY OF APPROACH AND CONCLUSIONS.

The section 45 credit is reduced or offset for certain types of financial assistance. The Internal Revenue Service has provided little administrative guidance on the offset rule for the section 45 credit. This is due to the relative newness of the credit and the simple structure of past developments. Three project owners last year separately asked the IRS to clarify the credit offset. Taking a cautious approach the IRS did not commit itself to a public position. Instead, the agency responded in private letter rulings which are good only for the persons and projects addressed.

Consequently, the scope of the section 45 credit offset needs to be extrapolated from its legislative history and from comparable offset provisions in other code sections. This paper first analyzes the purpose and limitations of the section 45 as well as the analogous section 29 and section 48 credit offset rules. The paper then examines different forms of government assistance that might be extended to wind projects in light of this analysis. The analysis and conclusions are summarized below.

Congress copied pre-existing offset rules when it drafted the section 45 credit. These earlier offset rules implement the congressional policy against double dipping – that is taxpayers' use of multiple government subsidies for the construction and acquisition of a renewable energy project. Congress framed the offset rules to deny the federal tax credit support to the extent a project is constructed or acquired with governmental assistance.

The IRS subsequently issued formal public guidance clarifying the application and limits of the older offset rules. While implying that the same limitations might apply to the section 45 credit, the IRS stopped short of a public commitment to follow the past guidance. If the administrative guidelines for the older offset rules do indeed apply to the section 45 offset rule, then price support payments and loan guarantees for a wind project should not jeopardize the section 45 credit. Nor should grants for operational costs, for transmission facility acquisition, and for substation construction offset the credit. On the other hand, grants which assist the construction of the project or assist the acquisition of equipment for the project will reduce the credit. Low-interest or no-interest capital cost loans will lead to the same result.

It is to be emphasized that these conclusions are extrapolated from the guidelines on the older offset rules in the section 29 and section 48 credits. As future wind developments secure governmental support, the owners will need to request IRS rulings on the projects to confirm the results under the section 45 credit.

III. DISCUSSION OF SECTION 45 AND ANALOGOUS OFFSET RULES.

A. Section 45 Renewable Electricity Production Credit.

Section 45 of the Internal Revenue Code provides a tax credit for the production of electricity from wind and other renewable resources. The credit is 1.5 cents for each kilowatt hour of electricity produced by the taxpayer at a qualified facility within ten years of the facility's original placement in service.

The credit is intended to serve as a price floor and it is phased out as the price of similarly generated electricity exceeds 8 cents per kilowatt hour. Both the phase-out price and the credit are adjusted for inflation. In 2001, the inflation-adjusted credit was 1.7 cents and the phase-out price was 9.3 cents. Notice 2001-33, 2001-19 Internal Revenue Bulletin 1155 (May 7, 2001).

The credit is also reduced or offset by certain other subsidies. Government grants, tax-exempt financing, subsidized energy financing, and other tax credits which the taxpayer receives for the project will offset the credit. The credit is reduced in proportion to the project's total capital cost coming from these sources. If a government grant covers 25% of the project's capital expenses, then the federal production credit is reduced by the same percentage.

Section 45(b)(3) sets out the following statutory rule:

> The amount of the credit determined under subsection (a) with respect to any project for any taxable year (determined after the application of paragraph (1) and (2)) shall be reduced by the amount which is the product of the amount so determined for such year and a fraction –
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> (A) the numerator of which is the sum, for the taxable year and all prior taxable years, of –
>
> (i) grants provided by the United States, a State, or a political subdivision of a State for use in connection with the project,
>
> (ii) proceeds of an issue of State or local government obligations used to provide financing for the project the interest on which is exempt from tax under section 103,
>
> (iii) the aggregate amount of subsidized energy financing provided (directly or indirectly) under a Federal, State, or local program provided in connection with the project, and
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> (iv) the amount of any other credit allowable with respect to any property which is a part of the project, and

(B) the denominator of which is the aggregate amount of additions to the capital account for the project for the taxable year and all prior taxable years.

The congressional conference report on the Energy Policy Act of 1992 contains this brief explanation of the section 45 offset rule: "A facility which has received the business energy credit or the investment credit is not eligible for the production credit. In addition, the credit is reduced proportionately for any governmental grants or subsidized financing received (including the use of tax exempt bonds)." House Report 102-1018, page 405, 102nd Congress, 2nd Session (October 1992). The same description was given by the Senate Finance Committee, Congressional Record S8487, Daily Edition (June 18, 1992), and the House Ways and Means Committee, House Report 102-474, Part 6, page 42, 102nd Congress, 2nd Session (May 5, 1992).

B. Section 48 and Section 29 Credit Offset Rules.

Congress inserted an earlier credit offset rule into the tax code when it enacted the section 48 energy investment tax credit in 1978 and again when it expanded this credit in 1980. Congress wanted to prevent developers from constructing or acquiring their projects with little financial commitment of their own. It did not want the credit to go to projects built chiefly with government subsidies. Congress therefore reduced the credit for certain kinds of government subsidies.

The conference report on the Crude Oil Windfall Profits Tax Act of 1980 explained the underlying policy as follows:

> The conference agreement provides rules to coordinate the business energy credits with other government subsidies for energy-related expenditures. The conferees are concerned that if no such rules were adopted, the compound effect of various subsidized loan and grant programs could lead to a situation in which the taxpayer could purchase this property with very little expenditure of his own funds. A potential result could be the encouragement of inefficiency through expenditures for equipment the production of which would require diverting substantial resources from more effective uses. The effect of the rule provided in the conference agreement, in conjunction with the present treatment of nontaxable grants, is that the purchaser of the eligible equipment must choose between the tax credit, on one hand, and subsidized energy loans and nontaxable grants, on the other hand. Grants which are taxable are not taken into account under these rules because their taxation serves as a partial offset; similarly, credits against State and local income taxes are not taken into account because the deductibility of these taxes under the Federal income tax implies that the effect of these credits is equivalent to the effect of a taxable grant.
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> Under present law, in general, if property is financed with nontaxable government grants, the tax basis in the property, for such purposes as depreciation and investment credits (including energy investment credits), is reduced to the extent that the property is financed with such grants; these rules which partially offset the benefit of these grants, are not changed under the conference

> agreement. The conference agreement provides a similar rule, but only for the purposes of the energy credit, to the extent that property is financed with tax-exempt industrial development bonds or certain other government subsidized financing.
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> * * *
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> Subsidized energy financing means financing provided under a Federal, State, or local program, a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy. Subsidized financing includes, but is not limited to, the direct or indirect use of tax-exempt bonds for providing funds under such a program. Subsidized financing does not include, however, loan guarantees.

House Report No. 96-817, pages 136 & 137, 96th Congress, 2nd Session (March 7, 1980).

Congress in the same 1980 legislation enacted a production-type credit, now in section 29 for nonconventional fuels production, with the same policy against double dipping. Building on the section 48 energy investment credit offset, section 29 specifies in more detail the types of assistance which reduce the production credit. The credit is to be offset for grants, tax-exempt bonds, and subsidized energy financing. Section 29(b)(3) states:

> (A) In general. The amount of the credit allowable under subsection (a) with respect to any project for any taxable year (determined after the application of paragraphs (1) and (2)) shall be reduced by the amount which is the product of the amount so determined for such year and a fraction –
>
> (i) the numerator of which is the sum, for the taxable year and all prior taxable years, of –
>
> (I) grants provided by the United States, a State, or a political subdivision of a State for use in connection with the project,
>
> (II) proceeds of any issue of State or local government obligations used to provide financing for the project the interest on which is exempt from tax under section 103, and
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> (III) the aggregate amount of subsidized energy financing (within the meaning of section 48(a)(4)(C)) provided in connection with the project, and
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> (ii) the denominator of which is the aggregate amount of additions to the capital account for the project for the taxable year and all prior taxable years.

The conference report on the section 29 offset rules explained that the amount of the offset reflects the amount of capital cost assistance. The report said:

> To the extent that the credit is available for the production and sale of any of the eligible sources, it is reduced in proportion to Federal, State, and local grants, subsidized energy loans, and tax-exempt financing provided *in connection with the construction or acquisition of the facility or its equipment*. [Emphasis added.]

House Report No. 96-817, page 140, 96th Congress, 2nd Session (March 7, 1980). A description of this capital cost assistance offset is also found in Senate Report 96-394, page 89, 96th Congress, 1st Session (November 1, 1979) – referring to "grants used to construct or acquire the facility or its equipment" – and in the General Explanation of the Crude Oil Windfall Profit Tax Act of 1980 by the Staff of the Joint Committee on Taxation Staff, pages 82-83 (1981). Thus, grants which subsidize the project's construction and acquisition cost will reduce the section 29 credit.

Section 29(b)(3)(A)(i)(III) explicitly adopts the section 48 definition of subsidized energy financing by cross reference. Congress' coordination of the offset rules for these two credits is not surprising, since the same legislation which expanded the investment-type credit for energy property in section 48 also included the production-type credit for nonconventional fuels in section 29 credit.

C. <u>Administrative Interpretation of the Section 48 and Section 29 Offset Rules.</u>

The Internal Revenue Service in 1981 promulgated a regulation to implement the section 48 energy investment credit, and in 1982 it proposed a supplemental regulation to implement the section 48 offset rule. The supplemental regulation was not finalized because the credit as then enacted, expired and was revised when the credit was later extended. The proposed regulation nevertheless explains the scope of the section 48 offset rule. Section 1.48-9(o) of the proposed regulation – focusing on subsidized energy financing – stated:

> (2) General rule. For purposes of the energy credit, qualified investment in any energy property (determined without this paragraph (o)) is reduced by the amount of subsidized borrowed funds *used to finance in whole or in part the energy property*. Funds borrowed are subsidized if they are directly or indirectly attributable to the proceeds of exempt IDB's [industrial development bonds whose interest is excluded from income under section 103] or subsidized energy financing.
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> (4) Subsidized energy financing. (i) Funds are attributable to subsidized energy financing if the source of the funds for financing (other than exempt IDS's) is provided directly or indirectly (such as in association with, or through the facilities of, a bank or other lender) by, or through, a government agency under a program a principal purpose of which is to provide (or assist in providing) financing for projects designed to conserve or produce energy. For purposes of this paragraph (o), a government agency is a State or local governmental unit referred to in §1.103-1(a) or the Federal government.
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> (ii) Subsidized energy financing does not include a grant includible in gross income under section 61, a nontaxable government grant, or a credit against State or local taxes. *Loan guarantees, price guarantees, purchase commitments, price support loans, and similar arrangements are not considered subsidized energy financing unless the arrangement is essentially subsidized borrowing under paragraph (o)(4)(i) of this section.*

(iii) The following examples illustrate this paragraph (o)(4).

* * *

Example (4). *State C wishes to encourage the production of synthetic fuels. As an inducement to Corporation X to build a synthetic fuel production plant, C enters into a contract with X guaranteeing X a certain price for the first 1,000 barrels of daily production. Before the plant is operational and pursuant to the price guarantee commitment, X receives an interest free advance of $10,000. Since the advance of funds is essentially a subsidized energy loan, it is considered to be subsidized energy financing*. [Italics added.]

Thus, the section 48 energy credit is proportionally reduced for energy property which is financed with certain types of governmental programs. Tax-exempt industrial development bonds and subsidized energy financing – but not price guarantee payments – will offset the credit. The preamble to the proposed regulation further explained: "[P]rice guarantees and purchase commitments are not considered subsidized energy financing since these types of arrangements confer only a contingent benefit. However, if funds are advanced under a price guarantee or a purchase commitment agreement which, in effect, results in a loan (for example, where payments under the agreement are made before the project becomes operational), these advances are considered to be subsidized energy financing." Federal Register, Vol. 47, No. 17, page 3559 (January 26, 1982).

Later in its public guidance on the section 29 offset rule for the nonconventional fuels production credit, the Internal Revenue Service took the position that the same limitation will apply. It stated, in Revenue Ruling 85-77, 1985-1 Cumulative Bulletin 14, that assistance used to construct or acquire a project will reduce the section 29 credit, but it determined that price support payments from a governmental agency do not constitute such capital cost assistance to reduce the credit. The IRS stated:

> The legislative history indicates that the grants referred to in section 29(b)(3)(A) of the Code are grants for capital costs of the fuel project. Price-support payments are based on the sale of the fuel, and are not such grants. The legislative history further indicates that price supports do not reduce the credit but are to be taken into account by the granting agency in setting the level of price support. The credit is, therefore, not affected by the price-support payments.

This revenue ruling is based on two earlier cases where the IRS provided more details of its rationale. In Private Letter Ruling 8410092 (December 7, 1983), a federal corporation agreed to pay a producer the difference between the lower market price and the established support price for the qualified fuel. Reviewing the offset rule (then contained in section 44D of the tax code), the IRS observed that the Senate Finance Committee, which had first proposed the credit, said that federal agencies should factor in the economic benefit of the tax credit when they determined the level of price supports and loan guarantees. The committee said: "It is anticipated that the credit will be taken into consideration by any Federal instrumentality in conjunction with decisions relating to loan guarantees, price supports, purchase agreements, etc." Senate Report No. 96-394, page 89, 96th Congress, 1st Session (November 1, 1979). The initial Senate proposal would have reduced the credit only for federal grants and tax-exempt financing, but the final conference provision expanded the offset rule to include state and local government grants as well as subsidized energy loans.

Relying on this legislative background, the IRS determined that the price support payments addressed in the private letter ruling are not capital cost grants to reduce the credit. The IRS explained:

> The legislative history of the [Crude Oil Windfall Profit Tax] Act indicates that the reduction in the credit provided for in section 44D(b)(3) of the Code applies to grants, tax-exempt bonds, and subsidized energy financing provided in connection with the construction or acquisition of the facility. The price support given ... is for the sale of the Product from the facility not its construction or acquisition.
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> The committee statement that it is anticipated that federal agencies will take the credit into account in decisions relating to price supports implies both that a taxpayer may receive both the credit and price supports and that price supports are not one of the categories of financing for which a reduction in credit is required. Additionally, Company C [the federal corporation] has represented that [it] has taken the credit into account in setting its price supports. We thus conclude that under the circumstances the price support payments provided by Company C to the Partnership are not grants for purposes of section 44D(b)(3) of the Code and will not reduce the amount of credit provided under section 44D(a).

Again, in Private Letter Ruling 8428035 (April 6, 1984), a federal agency provided a price guarantee as well as a loan guarantee for a shale oil project. The loan guarantee covered the project construction, and the price guarantee assured a certain level of income from sale of the shale oil. The agency would make up the difference between the guaranteed price and the actual market price, if lower. The market price was at that time below the guaranteed price

The Internal Revenue Service ruled that the price support payments which the federal agency made to the project owner did not reduce the section 29 renewable fuels credit for the project. The IRS said:

> The legislative history and the wording of section 44D(b)(3) of the Code [the credit offset rule] also indicate that the grants that reduce the credit are grants for the construction or acquisition of the facility. The price support payments are for the sale of shale oil produced at the facility not for its construction or acquisition.
>
> Consequently, it is concluded that neither the loan guarantees nor the price support payments provided by the Federal Instrumentality to the Partnership are grants for purposes of section 44D(b)(3).

The section 29 rulings, the proposed regulation under section 48, as well as the legislative history of both credits, indicate that their respective offset rules apply only to grants and financing which subsidize project construction and equipment acquisition. These credits are not reduced for loan guarantees, purchase commitments, price support loans, price support payments, or other non-capital cost assistance.

D. Application to Section 45 Credit.

While the IRS has not issued public guidelines for the section 45 credit offset rule, the comparable rules in section 29 and section 48 credits do show how the IRS might interpret section 45. Reliance on these older offset rules would be in line with Congress' references to these credit in the reports on the new section 45. The legislative history shows that two pre-existing offset rules served as models for the new section 45 wind credit in 1992. The nearly identical offset rule in section 45 demonstrates how closely Congress followed the earlier section 29 nonconventional fuels production credit.

The IRS itself has said, in nonbinding statement, that past interpretations of the section 29 offset rule might apply to section 45. There the IRS reviewed the proposed California price support payment or incentive production payment program. Under this program, the California Energy Commission would make monthly or quarterly payments to qualified project owners based on the number of kilowatt hours of electricity produced. The payment for each kilowatt hour would depend on the target price for that particular technology, the shortfall in the market price, and available state funds.

Administrative rules prohibit the IRS from issuing a definitive ruling on the price support program to the California Energy Commission. But in a general information letter dated August 29, 1997, the IRS described the conclusion which Revenue Ruling 85-77 had reached – that price support payments do not offset the section 29 credit. Reviewing Congress' reliance on the section 29 credit as a model for section 45, the IRS said:

> This legislative background suggests that Congress intended to apply the § 29 safeguards and limitations to the § 45 credit and that the results pertaining to credit offsets under § 29 are warranted under § 45. Therefore, there is a strong inference that the offset rules under § 45 should apply only to grants, credits, tax-exempt financing, subsidized energy financing, and other credits [sic] that relate to the construction or acquisition of the facility or its equipment ....

Informally the IRS staff added that they would probably follow this reasoning if California developers were to seek rulings on their individual projects.

The IRS again implied that reliance on prior interpretations of the section 29 credit offset rule might be appropriate in Private Letter Ruling 200142018 (July 23, 2001). In discussing the relevant authorities for the section 45 offset rule, the IRS referred to the "similar reduction" in section 29 and to the conclusion on price support payments in Revenue Ruling 85-77. The IRS here ruled that a state's green credit program will not offset the section 45 credit. The state credit was not a tax program. Rather, utilities in the state had to purchase a required amount of green credits from renewable energy producers.

Subsequently in Private Letter Ruling 200202048 (October 10, 2001), the IRS described the subsidies which offset the section 45 credit as those financing the project's capital cost. The IRS said "that § 45(b)(3) requires a reduction in credit in proportion to a facility's capital cost which is financed by government grants, proceeds of government issued tax-exempt obligations, subsidized energy financing under a government program, and any other credits." In other words, the IRS recognized that the grants, bonds, and financing assistance which offset the section 45 credit must relate to the capital construction and acquisition expenses. Such an interpretation is consistent with the IRS guidance under section 29. In this particular case the IRS concluded that production incentive paid by a charitable community development organization using a utility company's contributions did not offset the section 45 credit because the assistance was not governmental.

In Private Letter Ruling 200206034 (November 8, 2001), the IRS when discussing relevant legal authority referred again to section 29. It also described the scope of the section 48 offset rule and noted the latter's pertinence to interpreting the other credit offset rules. In this case, the IRS held that refund of a state's sales and use tax did not offset the section 45 credit.

These three private letter rulings and the 1997 general information letter illustrate the IRS' reliance on section 29 and section 48 offset rules to define the scope of the offset rule in section 45. Private letter rulings, as mentioned earlier, are not public guidance. Only the taxpayer named in the letter can rely on the ruling. Others may not cite the ruling as controlling authority. Each wind project owner must therefore obtain its own private ruling from the IRS to insure that a specific type of assistance will not reduce the section 45 credit. But the analysis of the offset rules for these other credits do indicate the likely IRS conclusion on the following types of assistance under section 45:

IV. REVIEW OF SPECIFIC TYPES OF GOVERNMENTAL ASSISTANCE.

A. Grants Which Buy Down the Project's Capital Cost.

Any NYSERDA grant to assist the construction or acquisition of a project will trigger a reduction of the renewable electricity production credit. Section 45(b)(3)(A)(i) covers "grants provided by the United States, a State, or a political subdivision of a State for use in connection with the project." House Report 102-1018 at page 405 broadly states that "the credit is reduced proportionately for any governmental grants or subsidized financing received (including the use of tax exempt bonds)." The congressional reports on section 29 and section 48, as well as the proposed regulation 1.48-9(o), Revenue Ruling 85-77, and the related private letter rulings, all apply the older offset rules only to capital cost subsidies. Furthermore, the IRS letter to the California Energy Commission and Private Letter Ruling 200206034 on the state sales tax refund, suggest that this limitation also pertain to the section 45 credit. Consequently, the wind credit should be offset only for grants that subsidize the developer's capital cost for the project.

It is to be noted that a capital grant will also entail a loss in the depreciation allowance. Where a grant is a contribution to capital – subsidizing the owner's construction or acquisition cost – the depreciation basis for the project is reduced. The reduction in depreciation together with the credit offset may well cancel the benefit of the grant. If the grant does not provide such capital cost subsidy, however, it would neither offset the credit nor reduce the basis for depreciation.

B. <u>Price Support Payments.</u>

NYSERDA payments to cover inadequate receipts for wind-generated electricity should not offset the section 45 credit. The IRS in Revenue Ruling 85-77, Private Letter Ruling 8410092, and Private Letter Ruling 8428035, addressed supplemental payments from a governmental agency that made up the shortfall between a per-barrel target price and the lower market price for shale oil. As these rulings explained, such price support payments do not relate to capital expenditures for the project's construction or acquisition. The payments, instead, are contingent on fuel production. Since they are not capital cost subsidies, the support payments will not reduce the section 29 credit.

Citing the section 29 revenue ruling, the IRS indicated in its letter to the California Energy Commission that price support payments under similar circumstances would not reduce the section 45 wind credit. It implied that this would be the conclusion reached for individual project owners under the California program that covered the gap between a target price and the lower market price, as long as the recipient treated the payment as taxable income. To match the situation which Congress contemplated and which the IRS approved under section 29, the governmental agency ought to take the federal production credit into account when setting its payment level and the recipient needs to report the payment as taxable income.

C. <u>Production Incentive Payments.</u>

NYSERDA incentive payments for actual production and sale of wind-generated electricity should not reduce the section 45 credit. A price support payment seeks to make up the difference if the actual receipts fall short of an established target price for energy production. A production incentive payment, in contrast, provides a supplemental payment for each kilowatt hour of electricity generated without depending on the actual shortfall in receipts. The incentive payment rate, however, should still be set with the anticipated price receipt and the federal tax credit in mind. The expected tax credit and rate of payment under a long-term power purchase agreement ought to be factors in negotiating a reasonable production incentive payment. Since the payment is not in connection with project construction or acquisition, the production incentive should not affect the wind production credit.

Along these lines, a production incentive payment, similarly to the California program, might be made quarterly or monthly for the prior period's output. The non-capital, contingent nature of the incentive would be corroborated by the requirement that the recipient generates and sells the energy as pre-condition for payment. The production incentive payment and the price support payment might even be made in advance, if the right to the payment is similarly conditioned on actual production and sale. Consistent with Example 4 in proposed regulation §1.48-9(o), the advance cannot be made until the supporting agency receives proof that the project has started commercial operation and is delivering power. Moreover, the recipient must be required to re-pay the advance to the extent the required amount of power is not generated and sold within a certain period. As further confirmation of the advance's conditional nature, the reimbursement might be secured by a letter of credit in favor of the supporting agency. If the project owner fails to produce the requisite power or goes bankrupt before doing so, the agency can re-collect the advance through the letter of credit.

D. Grants to Meet Operational Costs.

By the same logic as the production incentive and price support payments, NYSERDA payments made to help cover a project's operational and maintenance costs should not offset the section 45 credit. Such payments to defray the wind farm's non-capital repairs and the maintenance workers' salaries do not relate to the facility's construction or acquisition.

E. Grants for Transmission and Substation Facilities.

Transmission and substation grants might not come under the credit offset. The section 45 offset language reduces the credit for grants provided in connection with the project as well as for tax-exempt bond financing and subsidized energy financing in connection with the project. The credit, however, applies to electricity generated at a qualified facility, not a qualified project. The IRS in Revenue Ruling 94-31, 1994-1 C.B. 16, explained that each "wind turbine together with its tower and supporting pad" owned by a taxpayer and placed in service during the eligibility period "is a separate qualified facility". The question then arises whether the word "project" in the offset rule is synonymous with "facility". If the "project" means all the wind turbines in the windfarm with their towers and pads, then transmission lines and a substation that deliver the electricity to the utility purchaser would fall outside the definition. In that case, a grant or subsidized financing to construct or acquire the transmission facilities and substation would not come under the section 45 offset rule.

Support for this definition might be gleaned from the Income Tax Regulation for the original section 48 energy investment credit. The regulation defined qualified property to exclude transmission property. Geothermal equipment "does not include any electrical transmission equipment, such as transmission lines and towers, or any equipment beyond the electrical transmission state, such as transformers and distribution lines." Regulation §1.48-9(c)(10)(v). Solar energy property is equipment that uses solar energy to generate electricity "up to (but not including) the stage that transmits or uses electricity." Regulation §1.48-9(d)(3). Eligible wind energy property uses wind energy to generate electricity but "does not include equipment that transmits or uses electricity derived from wind energy." Regulation §48-9(e)(1). An authoritative determination on this issue would require a ruling from the IRS.

F. Below-Market Interest Loans.

Low-interest NYSERDA loans for project construction and equipment acquisition will offset the wind credit. Similar to offsetting grants, the subsidized energy financing, which reduce the section 29 and section 48 credits, relates to the project's construction or acquisition. Subsidized financing enables the debtor to borrow money at a favorable rate. Loans at below market terms which lower a project's capital cost will reduce the section 45 credit.

In comparison, loans which a governmental agency provides at market rates, is not subsidized financing. See Private Letter Ruling 8432072 (May 8, 1984), where a federal financing bank extended a loan on terms comparable to commercial lenders. Market-rate financing, however, would offer little aid for project development.

G. Loan Guarantees.

NYSERDA's guarantee of a project's construction loan to insure repayment to the commercial lender should not trigger a credit offset. As the congressional reports and the proposed regulation on the section 45 credit state, the definition of offsetting subsidized energy financing does not include loan guarantees. The section 29 credit incorporates this definition by cross reference. The IRS' tacit application of the section 29 limitations in the California Energy Commission letter, indicate that the same definition should apply to section 45. This conclusion is strengthened by the IRS' inclusion of the section 29 and section 45 rules in its review of the relevant authorities for the section 45 offset in Private Letter Ruling 200141018 (on the state green credit program). It is further strengthened by the same references in Private Letter Ruling 200202048 (on the advance production incentive payment) and in Private Letter Ruling 200206034 (on the state sales tax refund). Therefore, the guarantee of a construction loan for a wind project should not reduce the section 45 credit.

V. CONCLUSIONS and POSTSCRIPT COMMENTS.

As the above review concludes, neither price support payments, production incentive payments, grants for operational expenses, nor loan guarantees for a wind project should reduce the section 45 credit. Grants for transmission facility acquisition and for substation construction also should not offset the credit. But any grant or financing assistance for the project's construction or equipment acquisition will reduce the credit.

These conclusions assume that the assistance is governmental. To be non-governmental, the subsidy must come from a non-governmental entity using funds which are not taxpayer-subsidized. Private Letter Ruling 200202048 held that under the section 45 offset rule the advance production incentive payment was non-governmental since it was paid by a private charity out of funds contributed by a private utility company. Furthermore, under the section 48 offset rule, the IRS took the position that subsidized energy financing would be deemed to be governmental if a government unit administered the program; this would be the result even if the funds came from a private source. See Private Letter Ruling 8530004 (April 30, 1985). Although other areas of the tax code may not be entirely consistent on this point, Internal Revenue Service attorneys have indicated that this position will govern the section 45 offset rule. In this light NYSERDA-administered grants and subsidized energy financing would be governmental assistance whatever the source of funding.

After NYSERDA develops a specific assistance program, its staff might wish to confer with the Internal Revenue Service before carrying out the program.