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Mr. Eric San Juan, Acting Tax Legislative Counsel
Mr. John Parcell, Deputy Tax Legislative Counsel
Treasury Department
1500 Pennsylvania Avenue, NW Room 3044
Washington, DC 2000

Dear Messrs. San Juan and Parcell,

On behalf of the National Hydropower Association, I am writing you with respect to the application of the investment tax credit (ITC) and Treasury Grants to qualifying hydropower facilities that were included in “The American Recovery and Reinvestment Act of 2009 (P.L. 111-5).”

The National Hydropower Association (NHA) is a nonprofit national association dedicated exclusively to advancing the interests of the hydropower industry and the development of new waterpower technologies. NHA represents 61 percent of the non-federal hydropower generated in the United States. Our 150 members generate or provide equipment and services to hydropower facilities across the country.

NHA strongly supports the incentives enacted in the American Recovery and Reinvestment Act (ARRA). As the Treasury Department drafts guidance for taxpayers considering making an election to claim the investment tax credit for their qualified facilities or applying for ARRA Section 1603 Grants, NHA members have encountered specific technical questions regarding the language that we hope the Treasury will answer. These issues are listed below.

- **Scope of hydropower property.** NHA members would like clarification on the scope of hydropower property that is eligible for the ITC and Section 1603 Grants. Under current law, property eligible for these tax incentives is limited to tangible personal property that is part of a “qualified facility” for purposes of IRC section 45, and any “other tangible property” (not including a building or its structural components) that is an “integral part” of a section 45 facility. NHA members believe that the substantial body of tax authority defining the scope of hydropower property that qualified for the ITC under prior law should be used as the basis of what constitutes “other tangible property” and whether such property is an “integral part” of the qualified facility.
- **Integral parts of hydropower facilities.** NHA members suggest that the “integral part” test be applied to the activity in which the qualified facility is used. As a result, costs that FERC and other government agencies determine are necessary to operate a facility and produce electricity should be treated as qualified property for purposes of the ITC and Section 1603 Grants. Examples of costs that should be allowed under the “integral part” test include: costs relating to the reservoir and dam structure; costs incurred for roadways servicing the reservoir and powerhouse; costs incurred for parking lots servicing the reservoir and powerhouse; costs incurred for land preparation and site work; costs incurred for other land improvements such as fence installation; and costs incurred for fishways, fishladders, skimmer walls, piney channels, draft tube extensions, and flash boards.

- **Demolition costs incurred as necessary expense of installing incremental hydropower.** In order to make an election to claim the ITC for a qualifying hydropower facility, IRS Notice 2009-52 requires an accounting of the taxpayer's basis in the hydropower property. Qualifying hydropower facilities generating incremental hydropower, by definition, require that taxpayers incur expenses associated with demolition of existing facilities to achieve incremental generation gains and installation of new equipment. NHA seeks clarification as to the extent to which demolition expenses will be includible in the basis of tangible personal property and other tangible property that is an "integral part" of qualified hydropower facilities producing incremental hydropower.
- **Qualified Progress Expenditures.** Under current law, taxpayers are allowed to claim ITCs based on Qualified Progress Expenditures (QPEs) for construction of certain facilities. Now that taxpayers can elect to claim the ITC for investments in qualifying hydropower facilities, members are unsure how credits may be claimed based on QPEs. Specifically, if the ITC election is to be made for the year a facility is placed in service, how can a taxpayer elect to claim the ITC based on QPEs?
- **Interaction between QPEs and Section 1603 Grants.** IRC section 48(d)(2) suggests that a taxpayer may claim an ITC based on QPEs, and then both recapture the credit and obtain a Section 1603 Grant in the year that the facility is placed in service. However, according to Notice 2009-52, facilities receiving a Section 1603 Grant cannot also claim an ITC or PTC. NHA members would like clarification on this issue.
- **Cost Basis Calculations.** NHA members note that in determining the cost basis of property that qualifies for an ITC or Section 1603 Grant, it is not clear whether taxpayers should allocate costs between existing and incremental hydropower, and if so how that should be done. Guidance should ensure that appropriate engineering and accounting methods are used to calculate costs attributable to increased capacity or efficiency improvements. Additionally, NHA believes that compliance would be facilitated if Treasury were to provide a "safe harbor" illustrating how costs could be allocated. This provision could stipulate that in the case of shared facilities or costs, the taxpayer could choose to allocate the costs based on FERC's determination of incremental production as a percentage of historic average annual production or incremental capacity as a percentage of historical capacity.

NHA thanks the Treasury Department for the opportunity to comment on these issues affecting our members. NHA places itself as a resource at your disposal, if there are any questions with regard to hydroelectric facilities or equipment, please do not hesitate to contact me. In addition to answering any questions with regard to hydroelectric facilities or equipment, the association is willing to bring our members in for a meeting to discuss these issues further.

Sincerely,



Linda Church Ciocci
Executive Director