

## *Treasury Guidance Regarding Renewable Energy Grants in Lieu of Tax Credits Released*

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On July 9, 2009, the Treasury Department released long-awaited guidance concerning the application process and eligibility criteria to receive cash grants in lieu of renewable energy tax credits. The grant program was established by Section 1603 of the American Recovery and Reinvestment Tax Act of 2009 (the "Act"), which was enacted on February 17, 2009. The grant program is anticipated to stimulate the renewable energy sector, which has been slowed by the credit freeze and a lack of interest by tax credit investors. While the guidance includes a sample application form, along with a terms and conditions sheet that must be signed under penalties of perjury by the applicant, the Treasury Department has indicated that it will begin accepting applications on August 1, 2009 via online submission.

The guidance, sample application, and terms and conditions can be found at:

- <http://www.treas.gov/recovery/docs/guidance.pdf>;
- <http://www.treas.gov/recovery/docs/Application.pdf>; and
- <http://www.treas.gov/recovery/docs/energy-terms-and-conditions.pdf>, respectively.

### **Overview**

The Act authorizes taxpayers to receive cash grants ("Grants") in lieu of taking the investment tax credit ("ITC") under Section 48 of the Internal Revenue Code (the "Code") or the production tax credit ("PTC") under Code Section 45. To qualify, the taxpayer must place "specified energy property" in service in 2009 or 2010, or after 2010 if construction begins in 2009 or 2010 provided such property is placed in service by the end of 2012 (for wind), 2013 (for closed- and open-loop biomass, geothermal, landfill gas, municipal solid waste, qualified hydropower, and marine and hydrokinetic facilities), or 2016 (for solar).

The amount of the Grant will generally be 10 or 30 percent of the basis of the property depending on the type of property placed in service. Applications will be reviewed and Grant payments made within 60 days from the later of the date of the application submission or the date the property is placed in service. While the Grant is not considered gross income to the applicant (except as discussed in "Leased Property" below), the basis of the property for depreciation purposes is reduced by an amount

equal to 50 percent of the Grant payment. Additionally, applicants who receive a Grant under Section 1603 of the Act are not eligible for the PTC or ITC with respect to the same property for the taxable year of the payment or subsequent years.

### Application Procedures

- For property placed in service in 2009 or 2010, applications must be submitted after the property has been placed in service and before October 11, 2011. Treasury will make payment to qualified applicants within 60 days from the date the application is received. The Grant program is not competitive; thus, if the applicant qualifies, it will receive a Grant. In cases where applicants have not submitted sufficient information upon which Treasury can make a determination, the applicant will be given 21 days from the date of notice of such to submit additional information.
- For property not placed in service in 2009 or 2010 but for which construction began in 2009 or 2010, applications must be submitted after construction commences but before October 11, 2011. Treasury will review such applications and notify the applicant if all eligibility requirements that can be determined prior to the property being placed in service have been met. Applicants must then submit within 90 days after the date the property is placed in service sufficient information for Treasury to make a final determination. Treasury will then conduct a final review and make payment within 60 days to qualified applicants.
- The application form requests, among other identifying data elements, the applicant's Data Universal Numbering System ("DUNS") number from Dun and Bradstreet (such numbers can be obtained at no cost). Applicants must also register with the Central Contracting Registration ("CCR"). When Treasury determines that an application is approved, it will send a notice to the applicant and payment will be made no later than five days from the date of such notice by Electronic Funds Transfer based upon the banking information in the CCR.

### Applicant Eligibility

- An applicant must be the owner or lessee of the property and must have originally placed the property in service (see below for more detailed guidance with respect to leased property). Applicant eligibility will be determined as of the time the application is received by Treasury.
- A foreign person or entity may be eligible for the Grant if the person or entity qualifies for the exception provided in Code Section 168(h)(2)(B), which generally applies when more than 50 percent of the gross income generated by the property is subject to U.S. federal income tax.
- The following are not eligible to receive the Grants: Any federal, state, local, or tribal government entity, tax-exempt entity, cooperative electrical company, clean renewable energy bond lender, or any partnership or other pass-through entity of which one of the above entities is a direct or indirect partner. Real estate investment trusts and cooperatives are not considered pass-through entities for this purpose. Importantly, the guidance states that a pass-through entity having as a direct or indirect partner, shareholder, or similar interest holder a taxable C corporation, the shareholders of which are not eligible to receive Grant payments, does not affect the eligibility of the pass-through entity. Thus, "blocker" corporations can be used in situations where ineligible entities are participating in the projects ownership. However, the use of blocker corporations must be carefully analyzed due to the double taxation issues presented by such.

## Eligible Property

- Types of Property: Specified energy property includes only tangible property (but not including a building) that is an integral part of a qualified facility and for which depreciation or amortization in lieu of depreciation is allowable. Property is an integral part of a qualified facility if the property is used directly in the qualified facility, is essential to the completeness of the activity performed in that facility, and is located at the site of the qualified facility. Qualified facilities include those facilities described in Code Section 45 producing electricity from wind, closed- and open-loop biomass, geothermal, landfill gas, municipal solid waste, qualified hydropower, and marine and hydrokinetic renewable energy. In addition to property that is part of a qualified facility, the term “specified energy property” also includes any energy property described in Code Section 48 (e.g., solar, fuel cell, microturbine, small wind, and geothermal heat pump property). Only the portion of a facility that is specified energy property, along with the cost of installing it, will be taken into account in computing the Grant payment. For example, in the case of a building with solar property on its roof, only the cost of the solar property qualifies for the Grant; the cost of the building does not qualify. Property which is used predominantly outside the United States (i.e., located outside of the United States during more than 50 percent of the year) does not qualify for the Grant.
- Placed in Service: Specified energy property must be originally placed in service in 2009 or 2010, or placed in service after 2010 and before the applicable credit termination date (see above) if construction of the property begins in 2009 or 2010.
- Beginning of Construction: Construction is generally considered to begin when “physical work of a significant nature begins.” Guidance is provided for when physical work of a significant nature begins for both self-constructed property and property constructed by third-party contract. Notably, physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. For example, in the case of a facility for the production of electricity from a wind turbine, construction begins when physical work begins on the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation. Preliminary work such as site clearing, test drilling, or excavation to change the contour of the land (as distinguished from excavation for footings and foundations) does not constitute the beginning of construction.
- For property constructed under a written binding contract, construction begins when physical work of a significant nature begins under the contract. A contract is binding only if it is enforceable under State law against the applicant or a predecessor, and does not limit damages to a specified amount (e.g., by use of a liquidated damages provision). For this purpose, a contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount. A contract will continue to be binding if the parties make insubstantial changes in its terms and conditions or any term is yet to be determined by a standard beyond the control of either party. A contract that imposes significant obligations on the applicant will be treated as binding notwithstanding the fact that certain terms of the contract remain to be negotiated. However, option contracts and supply, or similar, agreements that do not include the amount and design specifications of the property to be purchased are not considered binding contracts.

- A safe harbor is provided allowing applicants to treat physical work of a significant nature as beginning when the applicant incurs or pays more than 5 percent of the total cost of the property (excluding the cost of any land and the preliminary activities previously mentioned).
- Units of Property: For purposes of determining the beginning of construction or the placed in service date, all the components of a larger property are a single unit of property if the components are functionally interdependent. For example, on a wind farm, each electricity-generating wind turbine, its tower, and its supporting pad are the single unit of property. The owner of multiple units of property that are located at the same site and that will be operated as a larger unit (e.g., a wind farm consisting of 100 wind turbines and related control systems) may elect to treat the units as a single unit of property for purposes of determining the beginning of construction and the date the property is placed in service. For purposes of the above 5 percent safe harbor, the entire cost of such larger unit is taken into account. In cases where multiple units of property are treated as a single unit, failure to complete the entire planned unit will not preclude receipt of a Grant. Thus, if in the above example only 90 of the planned 100 wind turbines are placed in service by the end of 2012 (the credit termination date), an otherwise eligible applicant would be eligible for a Grant payment based on the 90 turbines placed in service.
- Original Use: The original use of the property must begin with the applicant. If the cost of the used parts contained within a facility is not more than 20 percent of the total cost of the facility, the applicant will not fail to be considered the original user of the property. Additionally, the sale-leaseback rules applicable to Code Section 48 will apply when determining if the original use requirement is met. Thus, if new property is originally placed in service by a person and is sold to an applicant and leased back to the person by the applicant within 3 months after the date the property was originally placed in service, unless the lessee and lessor elect otherwise, the applicant-lessor is considered the original user of the property and the property is considered to be placed in service not earlier than when it is used under the leaseback.
- Required Documentation: Applicants must submit supporting documentation demonstrating that the property is eligible property and that it has been placed in service, or if placed in service after 2010, that construction began in 2009 or 2010. Required documentation includes, but is not limited to: final engineering design plans stamped by a licensed professional engineer; a commissioning report that certifies that the equipment has been installed, tested, and is ready and capable of being used for its intended purpose; for properties that are interconnected with a utility, the interconnection agreement; for properties that are under construction but not yet placed in service, paid invoices and/or other financial documents demonstrating that physical work of a significant nature has begun on the property; and for leased property, the written agreement with the lessor.

### Eligible Basis

- The basis of the property is determined in accordance with the general rules for determining the basis of property for federal income tax purposes. Thus, the basis of property generally is its cost, unreduced by any other adjustment to basis, such as that for depreciation, and includes all items properly included by the taxpayer in the depreciable basis of the property, such as installation costs and the cost for freight incurred in construction of the specified energy property. Costs that will be deducted for federal income tax purposes in the year in

which such costs are paid or incurred, such as Code Section 179 expenses, are not includible in the basis for purposes of determining the Grant payment. However, please note that it appears that the Code Section 168(k) 50 percent bonus depreciation does not reduce the eligible basis.

- Applicants must submit documentation to support a detailed breakdown of all costs included in the basis of the property. For properties that have a cost basis in excess of \$500,000 applicants must submit an independent accountant's certification attesting to the accuracy of all costs claimed as part of the basis of the property.

### Leased Property

- A lessor who is eligible to receive the Grant may make an irrevocable election by written agreement to allow the lessee of the property to receive the Grant. Such an election will treat the lessee as having acquired the property for its independently assessed fair market value on the date the property is transferred to the lessee, and will generally follow the applicable ITC rules governing elections to allow lessees to receive the credit.
- To make the election (i) the lessor must agree to waive all rights to a Grant, PTC, or ITC with respect to the property; (ii) the lessee must agree to ratably include in gross income over the 5 year recapture period an amount equal to 50 percent of the Grant payment; (iii) the lessor and lessee must both be persons eligible to receive a Grant payment; and (iv) the lessor cannot be a mutual savings bank or similar financial organization, a regulated investment company, or a real estate investment trust.
- In a sale-leaseback transaction, the following additional requirements must be met: (i) the lessee must be the person who originally placed the property in service; (ii) the property must be sold and leased back by the lessee, or must be leased to the lessee, within 3 months after the date the property was originally placed in service; and (iii) the lessee and lessor must not make an election to preclude application of the sale-leaseback rules.
- Note: Since the Treasury is willing to provide a Grant to lessees of a qualifying project, this may lend support to the ability of a lessee to take the ITC, which may lessen some practitioners' concerns about whether or not the lease pass-through structure is appropriate for ITC transactions.

### Recapture

- The Grant will vest ratably over a 5 year period, or 20 percent per year. If the applicant disposes of the property, or any interest in the property or the applicant, to a disqualified person, or the property ceases to qualify as specified energy property within 5 years from the date the property is placed in service, the unvested portion of the Grant must be repaid to the Treasury.
- A disqualified person generally includes a person who would not be eligible to receive the Grant if that person had placed the property in service (as previously discussed under "Applicant Eligibility"). Notably, and in contrast to the ITC rules, selling or otherwise disposing of the property to an entity other than a disqualified person does not result in recapture provided the property continues to qualify as specified energy property and provided the purchaser of the property agrees to be jointly liable with the applicant for any recapture.

- Where a lessor elects to pass the Grant payment to a lessee, and the lessor subsequently sells the property to a disqualified person, the lessee is liable for the recapture amount even if the lessee maintains control over the property. Applicants are not required to post a bond as a condition of receiving a Grant payment, and receipt of a Grant payment does not create a lien on the property in favor of the United States.

### **National Environmental Protection Act Review**

- Treasury has explicitly provided that “specified energy property” is not subject to the requirements of the National Environmental Policy Act (“NEPA”). NEPA typically requires comprehensive environmental review of “major federal actions,” including projects and programs entirely or partly financed by federal agencies, so that agencies can consider the environmental impacts of their decisions before they take major actions affecting the environment. Private activities can, as a result, become “major federal actions” by virtue of federal funding.<sup>1</sup> In this respect, NEPA can lead to significant delays for projects receiving federal financial support.
- While Treasury has not officially stated why the Grant payments will not trigger environmental review, it is likely because Congress has given Treasury almost no discretion in awarding grants to specified energy properties if the applicable requirements are met. Federal courts have consistently held that non-discretionary federal agency actions “do not trigger NEPA.”<sup>2</sup> Treasury’s approach to NEPA within the Grant guidance is also consistent with Treasury’s previous guidance on implementing NEPA’s mandates and guidance from the Council on Environmental Quality concerning the application of NEPA to projects funded by the Act.<sup>3</sup> Thus, because Congress didn’t give Treasury the discretion to decide whether to award Grants to specified energy property that otherwise meets the statutory conditions--eliminating Treasury’s ability to consider the environmental impacts of such projects before making a funding decision--Grants awarded under section 1603 of the Act will not trigger NEPA review.

### **Miscellaneous**

- Applicants may assign the Grant payment to a third party.
- A Grant payment does not make the property subject to the requirements of the Davis-Bacon Act.
- In the case of utilities, Grant payments must be normalized.
- Real estate investment trusts are eligible to receive Grant payments to the extent allowed by Code Section 50.
- Applicants will be required to provide reports, as required by Treasury, including an annual performance report. Additionally, applicants must maintain project, financial, and accounting records sufficient to demonstrate that the Grant was properly obtained.

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*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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<sup>1</sup> See *Sancho v. U.S. Dept. of Energy*, 578 F. Supp. 2d 1258, 1266 (D. Haw. 2008).

<sup>2</sup> *Friends of the Columbia Gorge, Inc. v. U.S. Forest Serv.*, 546 F. Supp. 2d 1088, 1100 (D. Or. 2007).

<sup>3</sup> See U.S. Dept. of Treasury, Directive 75-02, Environmental Quality Program, sec. 3 (Sept. 25, 1990); Memorandum to Heads of Departments and Federal Agencies from Nancy Sutley, CEQ Chair, Environmental Compliance and Guidance for Reporting NEPA Status and Progress for Recovery Act Activities and Projects, at 2 (Apr. 3, 2009).