

A Renewable Energy Law Update

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U.S. Treasury Department Issues Guidance for Cash Grants in Lieu of Energy Tax Credits

On July 9, 2009, the U.S. Treasury Department issued guidance for the award of cash grants by the federal government ("Grants") in lieu of energy tax credits under Section 1603 of the American Recovery and Reinvestment Act of 2009 ("ARRA"). When ARRA was enacted in February 2009, Congress recognized that current economic conditions have reduced investors' taxable income, and the attractiveness of the production tax credit ("PTC") and the investment tax credit ("ITC") as incentives for development of renewable energy projects has diminished. The goal in providing cash grants for a limited period is to spur renewable energy development, even in the absence of taxable income, and to further the goals of job creation and expansion of renewable energy sources.

The Grant, like the ITC, is equal to a percentage of the qualified construction cost of property placed in service as part of a renewable energy generation facility. The Grant amount is 30 percent of eligible costs for most types of generation facilities, including wind, solar and biomass, and 10 percent for a limited number of other types of facilities. The Grant amount is not included in the gross income of the recipient, and the depreciable tax basis of the qualifying property is reduced by one-half of the amount of the Grant.

- **Application Procedure.** Applicants interested in receiving a Grant may submit an application online by going to www.treasury.gov/recovery. An application for property placed in service in 2009 or 2010 may be submitted only after the project is placed in service. An application for property that will not be placed in service in 2009 or 2010 may be submitted after construction commences. *All* applications must be received before the statutory deadline of October 1, 2011. Although the guidance includes a sample application form, Treasury is not yet accepting applications but is expected to so do beginning on August 1. The guidance states that Treasury will make payment of the Grant within 60 days after receipt of a completed application.
- **Applicant Eligibility.** Certain persons are not eligible to receive Grants. These include any Federal, state or local government (including any political subdivision, agency or instrumentality of a Federal, state or local government), any tax-exempt organization described in IRC Section 501(c), a qualified issuer of clean renewable energy bonds under IRC Section 54(j), and any partnership or other pass-through entity having a direct or indirect partner (or other holder of an equity or profits interest) that is an ineligible organization or entity. A person that would be an ineligible Grant recipient under these

restrictions may own an interest in the project if it does so through a taxable C corporation.

- **Property and Payment Eligibility.** The eligibility of property for a Grant will be determined based on, among other factors, the "placed in service" date for the property, the date construction of the property begins (for facilities not placed in service by December 31, 2010), original use of the property by the applicant, submission of required documentation and qualification of the property as "specified energy property." Following are several interesting points to note:

- *Placed in Service.* Property may be eligible for a Grant if it is originally placed in service between January 1, 2009, and December 31, 2010 (regardless of when construction begins). If the construction of property begins between January 1, 2009, and December 31, 2010 (*see below*), the required placed in service date is January 1, 2013, 2014 or 2017, depending on the type of generation facility.
- *When Construction Begins.* Construction is considered to begin when "physical work of a significant nature" begins. For projects that are not placed in service prior to December 31, 2010, but must be commenced prior to that date, the guidance provides further detail on what type of action will constitute the commencement of construction, both for self-construction and for construction by contract. Notably, if a portion of the facility is to be assembled on-site from modular units manufactured off-site and delivered to the site, construction is considered to begin when physical work of a significant nature commences at the off-site location.
- *Aggregation of Units of Property.* In general, for purposes of both "placed in service" and "beginning of construction" determinations, the components of a larger property are considered to constitute a single unit of property only if the components are "functionally interdependent," meaning that the placing in service of one component is dependent on the placing in service of the other components. The guidance provides, as an example, that a wind turbine, its tower and its supporting pad are functionally interdependent and therefore constitute a single unit of property, but that multiple wind turbines on a wind farm are *not* functionally interdependent. The guidance also provides, however, that the owner of "multiple units of property that are located at the same site and that will be operated as a larger unit" may elect to treat all of the units (other than property placed in service before 2009) as a single unit of property. Such an election may provide significant advantages. For example, if an election is made for a wind farm, the commencement of construction of an individual turbine will be treated as the commencement of construction of the entire project. Completion of a portion of the turbines by the placed in service deadline will enable the applicant to receive a Grant calculated by reference to the cost of the completed portion.

- *Original Use of the Property by the Applicant.* The guidance reiterates that the original use of the property must begin with the applicant, but contains flexibility that will benefit sale-leaseback financing structures. In a sale-leaseback transaction, the project developer sells the project to an investor and leases it back for a period of time and for a lease rate calculated to provide an agreed-upon return to the investor. If the sale-leaseback occurs within three months after the date the property is originally placed in service, the guidance allows the investor/lessor to be treated as placing the property in service on the date it is first used by the lessee under the leaseback.
- *Pass-through of Grant to Lessee.* A lessor that is eligible to receive a Grant with respect to leased property may elect to pass the Grant to the lessee if the lessee is also a person eligible to receive a Grant. The guidance generally follows the existing rules applicable to the pass-through of energy tax credits to lessees.
- *Eligible Property.* The following types of energy property (as defined in the guidance) will qualify for the Grant: large wind, closed-loop biomass, open-loop biomass, geothermal eligible under IRC Section 45, landfill gas facilities, trash facilities, qualified hydropower facilities, marine and hydrokinetic, solar, geothermal eligible under IRC Section 48, fuel cells, microturbines, combined heat and power facilities, small wind and geothermal heat pumps.
- **Recapture.** The guidance provides that if, within five years after placement in service, property for which a Grant has been received is transferred to a person that itself is ineligible to receive a grant (a "disqualified person"), or if the property ceases to be eligible property, all or a portion of the Grant must be repaid ("recaptured"). The amount that must be recaptured is equal to 100 percent of the Grant reduced by 20 percent for each full year that has elapsed between the date the property was placed in service and the date of the disqualifying event. The guidance states that a transfer of property to a person that is not a disqualified person does not result in recapture if the transferee agrees to be jointly liable for subsequent recapture obligations, implying that recapture will result if the transferee does *not* so agree. The guidelines include a favorable clarification that the possibility of Grant recapture does not create a lien on the property in favor of the U.S. Government. This Treasury position should alleviate some complications in financing energy facilities where project lenders hold security interests in the facility.

For more information, please contact the Sustainability and Climate Change Law Practice Group at Lane Powell:

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