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# Treasury Grants for Energy Property in Lieu of Tax Credits

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## Jeffrey Davis

- Jeffrey Davis is a partner in the Tax Transactions Group of Mayer Brown LLP.
- Mr. Davis focuses on tax credit transactions and renewable energy finance.
- He has advised numerous equity investors in Section 45 transactions involving more than 50 wind farms, which collectively produce over 7,000 MW of electricity. In addition, he has significant experience with other tax credit transactions, including Section 45 (biomass, geothermal and solar), Section 48 (solar), and Section 45D (New Markets Tax Credits).

## Ellen Neubauer

- Ellen Neubauer is the Grants Program Manager within the Office of the Fiscal Assistant Secretary, US Department of the Treasury.
- Ms. Neubauer is responsible for overall management and supervision of the Section 1602 and 1603 grant programs under the American Recovery and Reinvestment Act of 2009.
- She has been practicing law for 29 years and is a former senior attorney in the US Department of the Treasury.

## IRS Circular 230 Disclosure

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  - (i) avoiding penalties under the Internal Revenue Code or
  - (ii) promoting, marketing, or recommending to another party any transaction or matter that is contained in this document.

## Overview

- Section 1603 of the American Recovery and Reinvestment Act of 2009 provides that the US Department of the Treasury will pay a grant in lieu of the Section 45 production tax credit (PTC) or the Section 48 investment tax credit (ITC) to reimburse a portion of the expense of certain specified energy property
- Grant is payable to “person” who places in service certain specified energy property either (1) during 2009 or 2010 or (2) after 2010 and before expiration of applicable PTC/ITC if construction began in 2009 or 2010

## Overview (cont'd)

- Amount is equal to specified percentage of basis in specified energy property
  - 30% for wind, closed-loop biomass, open-loop biomass, Section 45 geothermal, landfill gas, trash, qualified hydropower, and marine and hydrokinetic
  - 30% for solar, qualified fuel cell (subject to \$1,500 per 0.5 kw limitation), and qualified small wind
  - 10% for qualified microturbine (subject to \$200 per kw limitation), combined heat and power (subject to capacity limitations), Section 48 geothermal, and geothermal heat pump
- Grant payments will be made within 60 days of the later of these two dates
  - Completed application date
  - Placed-in-service date

# Application Procedures

- As of July 31, 2009, Treasury is now accepting applications
- Where applications must be submitted: online at <https://treas1603.nrel.gov>
- When applications must be submitted:
  - For property placed in service in 2009 or 2010, after the property is placed in service
  - For property not placed in service in 2009 or 2010, but for which construction began in 2009 or 2010, after construction commences
    - Supplemental information may be required after property is placed in service
  - In all cases, before October 1, 2011

# Application Procedures (cont'd)

- Completed application includes:
  - Completed and signed application form
  - Signed statement of Terms and Conditions
  - Complete payment information
    - Applicants must register with the Central Contractor Registry (CCR)
  - Detailed breakdown of all costs included in basis of eligible property
  - Final engineering design documents relating to the property
  - Data Universal Numbering Systems (DUNS) from Dun and Bradstreet
  - Other supporting documentation



# Determinations and Grant Payments

- Applicant will be notified if submission is insufficient and given 21 days to submit additional information
- When Treasury determines an application is approved, it will send a notice to the applicant, and it will make payment no later than five days from the date of the notice
- Treasury determinations with respect to applications are considered the final agency action
  - No appeals process
  - No administrative remedies
- Grant payments will be made by Electronic Funds Transfer

# Applicant Eligibility

- Certain persons are not eligible to receive grants:
  - Federal, state and local governments (or any political subdivision, agency, or instrumentality thereof)
  - Certain tax-exempt entities (e.g., charities and non-profits)
  - Clean renewable energy bond lenders
  - Cooperative electric companies
  - Any partnership or other pass-through entity that has as a partner (or other holder of an equity or profits interest therein) one of the preceding entities, unless such ownership is held through a taxable “blocker” corporation
- Non-US persons are eligible to receive grants provided that more than 50% of the gross income from the property is subject to US tax
- Applicant eligibility is determined as of the time application is received

## Property Eligibility: Placed in Service

- Grant available only for specified energy property:
  - Placed in service during 2009 or 2010, or
  - Construction of which began in 2009 or 2010 and which is placed in service after 2010 but before the applicable credit termination date

<b>Resource for Specified Energy Property</b>	<b>Credit Termination Date</b>
Large Wind	January 1, 2013
Closed-Loop Biomass, Open-Loop Biomass, Geothermal (Section 45), Landfill Gas, Trash, Qualified Hydropower, and Marine and Hydrokinetic	January 1, 2014
Solar, Geothermal (Section 48), Fuel Cells, Microturbines, Combined Heat and Power, Small Wind, Geothermal Heat Pumps	January 1, 2017

## Property Eligibility: Placed in Service

- “Placed in service” means ready and available for its specific use
  - Commissioning report by project engineer that certifies that equipment has been installed, tested and is ready and capable of being used for its intended purpose must be submitted with application for property placed in service in 2009 or 2010
- Property must be *originally* placed in service by the applicant

# Property Eligibility: Construction

- Construction is considered to commence when physical work of a significant nature begins
- Self-constructed property
  - Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching
  - In general, only physical work at the project site is considered
    - Excavation for foundation, setting of anchor bolts into the ground, or pouring concrete pads for the foundation
    - But not preliminary work such as clearing a site, test drilling to determine soil condition, or excavation to change land contour
  - Off-site physical work may be taken into account where the project is composed of modular units manufactured elsewhere and delivered to the project site for assembly

# Property Eligibility: Construction (cont'd)

- Property constructed by contract
  - Construction begins when physical work of a significant nature begins under a written binding contract
  - Written binding contract must be enforceable under state law and not limit damages to a specified amount (e.g., liquidated damages)
    - Limitation on damages of 5% or more of contract price is not considered to limit damages to a specified amount
    - Contracts providing full refund in lieu of damages are not binding
    - Contract is binding even if subject to conditions, if such conditions are not within the control of either party
    - Binding contract does not include supply agreement if the amount and design specifications of the property have not been specified

# Property Eligibility: Construction (cont'd)

- Safe harbor
  - Permits applicant to treat physical work of a significant nature as beginning when the applicant incurs more than 5% of the total cost of the property (excluding the cost of any land and preliminary activities)

# Property Eligibility: Units of Property

- For purposes of determining when property is placed in service or construction begins, all components of a larger property are treated as a single unit if they are functionally interdependent
  - Functionally interdependent means that the placing in service of one component is dependent on the placing in service of the other component
  - For example, in the case of a wind farm, each wind turbine can be separately operated and metered and can begin producing electricity individually, and thus each wind turbine is considered a single unit of property



## Property Eligibility: Units of Property (cont'd)

- Owner of multiple units of property located at the same site that will be operated as a larger unit may elect to treat the units (and any property, such as a computer control system, that services some or all such units) as a single unit of property for purposes of determining the beginning of construction and the placed-in-service date
  - Owner may not include within this larger unit any property that was placed in service before 2009
  - For example, in the case of a wind farm, the applicant may elect to treat as a single unit of property all wind turbines, their associated towers, their supporting pads, the SCADA system, and associated power condition equipment

# Eligible Basis and Accountant's Certification

- Amount is equal to specified percentage of basis in specified energy property
- Basis of property is determined under general rules for tax purposes
  - Section 1012 cost basis
    - Unreduced by depreciation
    - Includes items properly capitalized, such as installation costs and cost for freight incurred during construction
  - Costs that will be deducted in the year paid or accrued are not includible
- Application must include detailed documentation supporting cost basis
  - For requested payments of \$1 million or more, independent accountant's certification attesting to accuracy of all costs claimed
  - For requested payments of less than \$1 million, if eligible basis is more than \$500,000, independent accountant's report attesting that certain procedures were followed in evaluating the basis of the property

# Leasing Rules

- Special leasing rules applicable to ITCs are generally available for grant payments
- Lessor who is eligible to receive a grant payment may elect to pass-through the grant payment to a lessee
  - Election only applies to property that would be eligible if owned by the lessor
  - Both lessor and lessee must be persons eligible to receive a grant payment, and certain lessees are precluded (e.g., mutual savings banks, RICs and REITs)
  - Lessor and lessee must agree that lessor waives right to grant payment, PTCs and ITCs
  - Lessee will be treated as having acquired the property for its independently assessed fair market value on the date of lease
  - Lessee must include amount equal to 50% of grant payment in gross income ratably over a 5-year period
  - Lessor does not suffer a basis reduction
  - Election is irrevocable and made by written agreement between lessor and lessee

## Leasing Rules (cont'd)

- In a sale-leaseback transaction, the lessee (who is not the owner) may receive the grant payment with respect to property if
  - Lessee originally placed the property in service;
  - Property is sold and leased back by the lessee, or leased to the lessee, within 3 months of being originally placed in service; and
  - Lessor and lessee must not make an election to preclude the application of the sale-leaseback rules
- If property originally placed in service by a person is sold to an applicant and leased back by the original person within 3 months of the date the property was originally placed in service, the applicant-lessor is considered the original user of the property and the property is considered placed in service not earlier than when used under the leaseback

## Recapture Rules

- Grant payments are recaptured if, within the recapture period, either
  - Any interest in the property or in the applicant or in a partnership or pass-through entity that directly or indirectly owns an interest in the applicant (other than through a taxable corporation) is sold or disposed of to an ineligible entity, or
  - The property ceases to qualify as specified energy property
- Recapture will not occur if property is sold or otherwise disposed of to an entity that is not ineligible, provided such entity agrees to be jointly liable with the applicant for any future recapture

## Recapture Rules (cont'd)

- Recapture period is 5 years following the placed-in-service date
- Recapture amount is a percentage of the grant payment
  - 100% in year 1
  - 80% in year 2
  - 60% in year 3
  - 40% in year 4
  - 20% in year 5

## Recapture Rules (cont'd)

- Recapture payments may be collected from:
  - The applicant
  - An entity that has purchased an interest in the property and has agreed to be jointly liable
  - The lessee of the property, if the grant was passed-through to such lessee
- Recapture payments may not be collected from the applicant's owners or lenders
- Applicants are not required to post any bond
- Receipt of grant payment does not create a lien on the property
- Recaptured amounts are not considered tax liabilities

## Assignment of Grants

- Applicants may assign their grant payments to a financial institution if certain conditions are satisfied:
  - Payment must be \$1,000 or more
  - Assignee must be a bank, trust company, or other financing institution, including any Federal lending agency
  - Assignment must cover all amounts, be made to one party, and not be subject to further assignment
  - Assignee must submit Notice of Assignment to Treasury



## Other Rules

- Grant is not includible in gross income
- Basis of property is reduced by 50% of grant amount
- Receipt of grant payments with respect to property will not cause such property to be subject to the requirements of
  - National Environmental Policy Act
  - Davis-Bacon Act
- REITs are eligible for grant payments only to the extent allowed under ITC rules
- Grant payment is subject to normalization rules

# Reporting

- Applicant shall provide project performance report on an annual basis for 5 years
  - Name of applicant
  - Current owner of property
  - Treasury application number
  - Name and location of project
  - Number of jobs retained
  - Installed nameplate capacity and annual production
- Applicant shall submit other reports Treasury deems necessary
- Applicant shall certify to Treasury on an annual basis for 5 years that the property has not been disposed of to a disqualified person and that the property continues to qualify as specified energy property