

Alerts & Publications

Treasury Provides Guidance on Grants in Lieu of Energy Production and Investment Credits

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On July 9th, the Treasury Department released guidance regarding the new grant program that allows certain energy property owners and lessees to obtain grants in lieu of claiming the Section 45 production tax credit (“PTC”) or the Section 48 investment tax credit (“ITC”). These grants (“Renewable Energy Grants”) were a part of the American Recovery and Reinvestment Act of 2009, the economic stimulus package enacted in February.

The guidance provides important information regarding eligibility and the application process for such grants.

Overview of the Renewable Energy Grant Program

Under the Renewable Energy Grant program, certain taxpayers may apply for a grant from the U.S. Treasury Department (“Treasury”) in lieu of the PTC or ITC with respect to certain renewable energy property. Renewable Energy Grants are not includable in federal taxable income (although the state tax treatment of these grants is unclear), but 50% of the amount of such grants is excluded from the basis of the property, reducing depreciation deductions over the life of the property. Acceptance of Renewable Energy Grant funds does not subject the property to the National Environmental Protection Act or the Davis-Bacon Act.

Eligible Applicants

Certain tax-exempt entities (including federal, state and local governments and 501(c)(3) organizations) and certain energy-related cooperatives (collectively, “Ineligible Persons”) are ineligible for Renewable Energy Grants, as are partnerships and other pass-through entities of which any Ineligible Person is a partner or equity owner (other than through a blocker corporation). REITs and RICs are not treated as pass-through entities for these purposes. However, eligibility of REITs for Renewable Energy Grants is substantially limited. In general, a foreign person is also an Ineligible Person unless at least 50% of its gross income derived from such property is subject to U.S. tax. Applicant eligibility is determined as of the time that the application is received, but subsequent changes may cause a Renewable Energy Grant to be recaptured, as discussed below.

Eligible Property

Renewable Energy Grants are available in the amount of 30% of the cost of depreciable wind, closed-loop biomass, open-loop biomass, specified geothermal, landfill gas, trash combustion, qualified hydropower, marine and hydrokinetic, fuel cell, solar and small wind property. Renewable Energy Grants are also available in the amount of 10% of the cost of other specified geothermal, qualified microturbine, combined heat and power system, and geothermal heat pump property. Costs deductible in the year the property is placed in service (e.g., costs expensed currently under

Internal Revenue Code Section 179) are not includable for purposes of determining Renewable Energy Grant amounts. Certain specified dollar limits apply to fuel cell, microturbine and heat and power system property, and special rules apply with respect to certain costs relating to the construction or acquisition of geothermal property.

In general, property must also be originally placed in service by the applicant in order to be eligible. Property that contains used parts with an aggregate cost of more than 20% of the property's total cost will not be eligible.

Subject to certain narrow exceptions, property that is used predominantly outside the United States also will not be eligible property.

Grant Recapture

Recapture provisions apply to property for which Renewable Energy Grants are obtained for five years from the date the property is placed in service. Under these rules, 100% of grant funds must be repaid if the property is transferred to an Ineligible Person or converted to a nonqualifying use within one year of the placed in service date. The recapture percentage declines to 80% during the second year, 60% during the third year, 40% during the fourth year and 20% during the fifth year. Property is considered to have been transferred to an Ineligible Person if any interest in the property or its owner (generally including an indirect interest in the owner held through a partnership or other pass-through entity) is transferred to an Ineligible Person. Note that this rule may be more stringent than the recapture rules for the ITC, particularly in the case of grant property held by a partnership or other pass-through entity. Accordingly, persons who take advantage of a Renewable Energy Grant should consider implementing transfer restrictions to prevent recapture.

Time Limitations

Renewable Energy Grants are available for a very limited period of time. In particular, they are available only if (i) the property is originally placed in service in 2009 or 2010, or (ii) construction begins during 2009 or 2010 and property is originally placed in service by a specified date (before January 1, 2013, 2014 or 2017, depending on the type of property), referred to as the "credit termination" date.

For this purpose, property is "placed in service" if it is "ready and available for its specific use," and construction begins when the applicant commences "physical work of a significant nature." "Physical work of a significant nature" does not include preliminary activities such as planning or design work, securing financing, exploring, researching or site clearing. Where property is manufactured or constructed for the applicant by another person, construction generally begins when physical work of a significant nature commences under a binding written contract that does not limit damages to an amount less than 5% of the contract price.

The Treasury guidance also provides a safe harbor under which an applicant may treat "physical work of a significant nature" as beginning when the applicant incurs or pays (depending on its accounting method) more than 5% of the total cost of the property, excluding the cost of land and preliminary activities.

For purposes of determining the placed in service date and the date construction begins, all of the components of a larger property are treated as a single unit of property if they are "functionally interdependent" (i.e., the placing in service of one component is dependent on the placing in service of another component). For example, the wind turbines on a wind farm are not functionally

interdependent if each turbine can be separately operated and metered and can produce electricity individually. An 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 those units (and any property that serves some or all of such units, such as a computer control system) as a single unit for purposes of determining the construction and placed in service dates. However, the applicant cannot treat any property placed in service before January 1, 2009 as part of the larger unit.

If an election to treat separate units as a single unit is made prior to the completion of construction and not all of the separate units are ultimately placed in service on or before the applicable credit termination date, the Renewable Energy Grant will still be available with respect to the proportionate amount of equipment actually placed in service on or before such date. Accordingly, if a taxpayer undertakes a large project that comprises multiple units (such as a wind farm), and construction of some of these units will not begin until after 2010, it may nevertheless be possible to qualify all of those units as eligible property if the entire project is designated as a single unit. However, if the taxpayer so elects, the construction start date may need to be determined with respect to the entire project, which could be later than the construction start date for a single unit within the project (if, for example, the 5% safe harbor is used). If the construction start date for the entire project is delayed until after 2010, the entire project would be rendered ineligible. Thus, taxpayers should weigh these considerations carefully.

Special Rules Applicable to Leased Property

A lessor that is eligible to receive a Renewable Energy Grant with respect to a particular property may make an irrevocable election to pass the grant through to the lessee, provided that such property would be eligible for a Renewable Energy Grant if owned by the lessee. The lessor must waive all right to a PTC or ITC with respect to the property, and the lessee must agree to include 50% of the amount of the Renewable Energy Grant in income ratably over a period of five years. If such election is made, the lessee will be treated (for purposes of determining the amount of the Renewable Energy Grant) as having acquired the property for its fair market value as of the date it is transferred to the lessee under the lease. The election is not available to a lessor that is a mutual savings bank or similar financial institution, or a REIT or RIC. In the case of a sale-leaseback, the election is generally permissible if (i) the lessee is the person who originally placed the property in service and (ii) the lessee sells the property and leases it back within three months of the date it was originally placed in service.

The Application Process

Applications for Renewable Energy Grants must be received by Treasury before October 1, 2011. For property not placed in service at the time of the application, Treasury will notify applicants as to whether the property meets all eligibility requirements that can be determined prior to placement in service, and such applicants will be required to submit supplemental information sufficient to support a final determination within 90 days after the date the property is placed in service.

The application form requires the provision of detailed information and supporting documentation, including in some cases third party reports and certifications. The application package also includes a set of Terms and Conditions that must be signed under penalty of perjury. The Terms and Conditions include, among other things, a statement that the applicant will not claim the PTC or ITC with respect to the property, and that the applicant will submit annual reports to Treasury for five years after the property is placed in service. The applicant also must agree to maintain project,

financial and accounting records, and to provide Treasury with a right of physical access to its facilities, and books and records. Information obtained by Treasury in connection with the application may be shared with other federal agencies, including the Internal Revenue Service, and Treasury may publicly release information about the applicant and/or the property.

For a general discussion of the energy tax provisions of the American Recovery and Reinvestment Act of 2009, see "[Stimulus Law Provides Billions to Support an Array of Energy Programs.](#)" For a discussion of some of the considerations relevant to choosing between the PTC, ITC and a Renewable Energy Grant, see "[Recently Enacted Stimulus Bill Expands Renewable Energy Tax Credits and Introduces Renewable Energy Grants.](#)"