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Treasury Revises Guidance for Renewable Energy Grant Program

The U.S. Department of the Treasury issued guidance in July 2009 for Treasury's renewable energy grant program.¹ This week, Treasury revised that guidance in regard to the "beginning of construction" requirement for renewable energy projects that are placed in service after 2010.²

Beginning of Construction Requirement

The Treasury grant program, enacted as §1603 of the American Recovery and Reinvestment Act of 2009, provides a cash grant for the development of certain renewable energy projects equal to 30 percent (or 10 percent for certain technologies) of the eligible costs of the project. The Treasury grant is available in lieu of the Internal Revenue Code (IRC) § 45 production tax credit and the IRC § 48 investment tax credit.

The grant is a limited time program that is available for renewable energy projects that are either (i) placed in service during 2009 or 2010; or (ii) placed in service after 2010 and before a termination date that varies based on the technology of the project, but only if construction of the renewable energy project began during 2009 or 2010.

Original "Beginning of Construction" Guidance

Treasury's July 2009 guidance addresses the circumstances under which a grant applicant is treated as having begun construction during 2009 or 2010. Under that original guidance, construction of a renewable energy project will be treated as having begun during 2010 only if "physical work of a significant nature" occurs during 2010. That original guidance provides both a facts and circumstances test and a safe harbor for determining whether physical work of a significant nature has occurred.

With respect to the facts and circumstances test, the original guidance provides examples of work that does and does not constitute physical work of a significant nature in two situations -- (i) self construction of the renewable energy project by the grant applicant and (ii) construction of the renewable energy project under a binding contract. Those examples were revised and clarified in the revised guidance; the revised examples are discussed below.

With respect to the safe harbor, the original guidance provides that physical work of a significant nature will be treated having occurred if the applicant incurs (in the case of an accrual basis applicant) or pays (in the case of a cash basis applicant) more than 5 percent of the eligible costs of the renewable energy project. Under that original guidance, for purposes of determining whether an accrual basis applicant incurred costs, the economic performance standards of IRC section 461(h) apply.

Revised "Beginning of Construction" Guidance

In general, the revised beginning of construction guidance allows grant applicants to more easily satisfy the beginning of construction requirement for obtaining the Treasury grant. As with the original guidance,

¹ For a copy of our Legal Alert that summarizes that guidance, please click [here](#).

² For a copy of the revised guidance, please click [here](#).

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the revised guidance provides that construction of a renewable energy project begins during 2010 only if physical work of a significant nature occurs during 2010 and allows applicants to meet that physical work of a significant nature requirement under either a facts and circumstances test or safe harbor rule.

- **Facts and Circumstances Test**

Under the facts and circumstances test, a grant applicant will be treated as having performed physical work of a significant nature with respect to a renewable energy project if the nature of its activities with respect to that project satisfy a particular threshold. In the revised guidance, Treasury clarifies that such activities include both work done on-site and work accomplished off-site. Treasury provides in the revised guidance two examples of on-site and off-site work that satisfies the necessary threshold to be treated as physical work of a significant nature:

- **Example 1: On-Site Physical Work**

In the case of a project for the production of electricity from a wind turbine, on-site physical work of a significant nature begins with the beginning of the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation.

- **Example 2: Off-Site Physical Work**

If the project's wind turbines and tower units are to be assembled on site from components manufactured off site and delivered to the site, physical work of a significant nature begins when the manufacture of the components begins at the off-site location.

As with the original guidance, Treasury makes clear in the revised guidance that physical work of a significant nature does not include preliminary activities such as planning or designing, securing financing, exploring, researching, clearing a site, test drilling of a geothermal deposit or to determine soil condition, or excavation to change the contour of the land (as distinguished from excavation for footings and foundations).

The relevant activities for the facts and circumstances analysis are those undertaken by the applicant and/or a contractor, depending on whether the applicant is constructing all or part of a renewable energy project itself, or has entered into a binding contract with another person to construct all or a part of the project:

- **Self Construction:** If a Treasury grant applicant manufactures, constructs or produces property for use in its trade or business, the work performed by the applicant is considered in determining whether physical work of a significant nature has begun.
- **Construction by Contract:** If a Treasury grant applicant enters into a binding contract for another person to manufacture, construct or produce property for use in the applicant's trade or business, the work performed under the contract is taken into account in determining when physical work of a significant nature has begun.

If a renewable energy project is constructed partially by the grant applicant and partially by another person, the activities of the applicant are taken into account with respect to the equipment self-constructed and the activities of the other person are taken into account with respect to the equipment constructed under a binding contract.

To qualify as a binding contract, the contract must be (i) enforceable under state law against the applicant (or a predecessor) and (ii) may not limit damages to a specified amount. A contract that limits damages

to an amount equal to at least 5 percent of the total contract price will not preclude the treatment of a contract as a binding contract. In contrast, a contract that provides for a full refund of the purchase price in lieu of any damages allowed by law in the event of breach or cancellation is not considered binding.

▪ **Revised Safe Harbor**

As with the original guidance, the revised guidance provides a safe harbor that allows a grant applicant to treat physical work of a significant nature as having begun if more than 5 percent of the costs of the renewable energy project are paid or incurred. The revised rules, however, significantly alter the determination of when costs are treated as paid or incurred. Most notably, the revised rules (i) eliminate the onerous requirement under that original guidance that required accrual basis taxpayers to meet the IRC section 461(h) economic performance standards to be treated as having incurred costs and (ii) include costs *either* paid or incurred by an applicant (or a contractor) without regard to whether the applicant (or contractor) is an accrual or cash basis taxpayer.

The revised safe harbor requires that more than 5 percent of the total cost of the renewable energy project must have been paid or incurred before the end of 2010. Whether costs are paid or incurred for purposes of the safe harbor depend on whether the renewable energy project property is self constructed or constructed under a contract:

- **Self Construction:** Costs of property are treated as having been paid or incurred when paid or incurred by the applicant.
- **Construction by Contract:** Costs of property are treated as having been paid or incurred when either (i) the property is provided to the grant applicant by the person that manufactured, constructed or produced the property or (ii) for periods before the property is provided to the grant applicant, as costs are paid or incurred with respect to the property by the person that manufactured, constructed or produced the property.

If a renewable energy project is constructed partially by the grant applicant and partially by another person, the costs paid or incurred by the applicant are taken into account with respect to the equipment self-constructed and the costs paid or incurred by the other person are taken into account with respect to the equipment constructed under a binding contract.

Reliance on Original Guidance

A Treasury grant applicant may determine when construction begins for a particular renewable energy project based on either the original guidance in effect before March 15, 2010, or the revised guidance described in this legal alert.



If you have any questions regarding this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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