

Client Advisory | July 2009

New Treasury Guidelines and Application Procedures for the Treasury Cash Grants in Lieu of Renewable Energy Tax Credits

On July 9, 2009, the Treasury released the new guidelines and application procedures for the stimulus program which reimburses taxpayers for the cost of renewable energy property. A grant from the U.S. Treasury ("Treasury Cash Grant") to the owner of renewable energy property ("Applicant") is given in lieu of certain renewable energy tax credits. This Client Advisory describes the new guidelines and application procedures for the Treasury Cash Grant program.



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Background

Internal Revenue Code ("IRC") Section 45 provides a production tax credit ("PTC") for electricity produced by a taxpayer from certain renewable resources during the ten-year period beginning on the date the production facility was originally placed in service. IRC Section 46 provides for an investment tax credit ("ITC") that includes the energy credit determined under IRC Section 48. The ITC amount is 30 percent of the cost basis of energy property placed in service. Section 1102 of the American Recovery and Reinvestment Act ("ARRA") and IRC Section 48(a)(5) allows taxpayers to irrevocably elect to take the ITC in lieu of the PTC with respect to certain renewable energy facilities.

Cash Grant Election

Section 1603 of ARRA allows a Treasury Cash Grant in the amount of the applicable percentage of the cost basis of specified energy property which is part of a "qualified facility" as defined by IRC Section 45. IRC Section 48(a)(5)(C) provides that taxpayers may elect to treat certain "qualified facilities" (within the meaning of IRC Section 45) as qualified investment credit facilities. Therefore, taxpayers that place in service new energy property eligible for the ITC or renewable energy facilities that are eligible for the PTC will have the option to take the

Treasury Cash Grant instead of claiming the ITC or the PTC. The grant amount is generally the same as the amount of the ITC that could be claimed, generally 30% of the cost of a renewable energy facility described in IRC Section 45. If Applicant accepts the Treasury Cash Grant, it cannot claim either the ITC or the PTC with respect to the same property.

The amount of the Treasury Cash Grant is based on the applicable percentage and the cost basis. The applicable percentage is either 30% or 10% depending on the type of energy property. Most renewable energy facilities will qualify for the 30% applicable percentage. Qualified cost basis is the cost of the energy property placed in service. Applicants must submit payment documentation and a detailed breakdown of all costs included in the basis to support the cost basis claimed for the property. Supporting documentation, such as contracts, copies of invoices, and proof of payment, must be retained by the Applicant and made available to Treasury upon request. 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.

The cost basis does not include costs that will be deducted for federal income tax purposes, like IRC Section 179 deductions.

The cost basis of a qualified facility also does not include the portion of the cost of the facility that is attributable to a non-qualifying activity. For example, for a biomass facility that burns fuel other than open-loop biomass or closed-loop biomass, the eligible cost basis is the percentage of total eligible costs that is equal to the percentage of the electricity produced at the facility that is attributable to the open-loop biomass and closed-loop biomass.

A Treasury Cash Grant with respect to specified energy property is not includible in the gross income of the Applicant. The basis of the property is reduced by an amount equal to 50% of the payment. A Treasury Cash Grant with respect to specified energy property does not make the property subject to the requirements of National Environmental Protection Act ("N EPA") or the Davis-Bacon Act.

Eligible Applicants

To receive a Treasury Cash Grant, Applicant must make an application with the Treasury before October 1, 2011. The Treasury Cash Grant will be paid no later than 60 days after the later of the date of the grant application or the date that the specified energy property is placed in service.

Applicant must be the owner or lessee of specified energy property that qualifies for a Treasury Cash Grant and must be the original user of the property. Applicant may not be a foreign person or entity unless it is a foreign person or entity that qualifies for the exception in IRC Section 168(h)(2)(B). Applicant may not be: (i) a federal, state or local government, or any political subdivision, agency or instrumentality thereof; (ii) an organization that is described in IRC Section 501(c) and is exempt from tax under IRC Section 501(a); or (iii) an entity referred to in IRC Section 54(j)(4) ("Disqualified Person"). Applicant may not be a partnership or pass-thru entity with Disqualified Persons acting as direct or indirect partners (or other direct or indirect holders of an equity or profits interest).

A taxable corporation whose shareholders are Disqualified Persons is not a Disqualified Person and such a corporation's ownership of an interest in a partnership or other pass-thru entity will not cause the partnership or other entity to be treated as a Disqualified Person. Therefore, partnership or pass-through entities may be structured so that partners, who are otherwise Disqualified Persons, own an indirect interest in the Applicant through a taxable C corporation. These blocker corporations will allow an otherwise qualifying partnership with tax-exempt investors to be an eligible recipient of a Treasury Cash Grant.

Specified Energy Property

Property eligible to receive a Treasury Cash Grant is "specified energy property." Specified energy property is tangible property that is an integral part of the facility. Specified energy property is property for which depreciation (or amortization in lieu of depreciation) is allowable. Specified energy property does not include a building but may include structural components of a building. Property which is used predominantly outside the United States is not specified energy property.

To claim a Treasury Cash Grant, Applicant must place specified energy property in service during 2009 or 2010, or must begin construction of specified energy property in 2009 or 2010 and place it in service before the end of 2012 for wind facilities, before the end of 2013 for other IRC Section 45 facilities and before the end of 2016 for any other ITC property. The original use of the property must begin with the Applicant. If a facility contains more than 20 percent used parts based on the total cost of the facility, the Applicant will fail to be considered the original user of property.

The following types of property are specified energy property: (i) a "qualified facility" as described in IRC Section 45(d) (1), (2), (3), (4), (6), (7), (9), or (11), but only if no credit has been allowed under IRC Section 45

for the facility; and (ii) "energy property" described under IRC Section 48. Specified energy property includes expansions of an existing property that is specified energy property under IRC Section 45 or Section 48.

Integral Part of the Facility

Property is an integral part of a qualified facility if the property is: (i) used directly in the qualified facility; (ii) essential to the completeness of the activity performed in that facility; and (iii) located at the site of the qualified facility.

Roadways and paved parking areas used for transport of material to be processed at the facility or equipment to be used in maintaining and operating the facility qualify as integral parts of the facility. Roadways or paved parking lots that provide solely for employee and visitor vehicle traffic, on the other hand, are not considered integral parts of a facility. Property used at the a qualified facility for unloading, transfer, storage, reclaiming from storage, or preparation (shredding, chopping, pulverizing, or screening) of the material to be processed at the facility are considered integral parts of a facility. But property that transports material or fuel to the qualified facilities, such as slurry pipelines, trucks, railroad cars, and barges, are not considered integral parts of facility.

For specified energy property that generates electricity, ancillary property that includes storage devices, power conditioning equipment, transfer equipment, and parts related to the functioning of those items are considered integral parts of the facility. Electrical transmission equipment, such as transmission lines and towers, or any equipment beyond the electrical transmission stage, such as transformers and distribution lines are not considered integral parts of the facility.

Construction Start and Placed In Service Dates

Applicant must begin construction on projects before certain deadlines

and before applying for the Treasury Cash Grant. Construction begins when physical work of a significant nature begins, such as when work begins on the excavation for foundations, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. Preliminary work, such as clearing a site, test drilling to determine soil condition, or excavation to change the contour of the land (as distinguished from excavation for footings and foundations) does not constitute the beginning of construction. Applicant may use a safe-harbor standard for the construction start date as the date when the Applicant incurs more than 5 percent of the total cost of the property (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching). The application includes a Narrative Description of Beginning of Construction where the Applicant must describe what construction activities have taken place to qualify for the construction start date. Paid invoices and/or other financial documents demonstrating that physical work of a significant nature has begun on the property must be submitted.

Placement in service is defined as the date on which the property is ready for its intended use. For an energy facility this date will usually be the commencement of operations date. The application must include documentation to establish that the property has been placed in service, such as commissioning reports and interconnection agreements. An interconnection agreement is the contract between the Applicant and the local utility that establishes the terms and conditions under which the utility agrees to interconnect with the Applicant's energy producing system. Additionally, the application must state: (i) the name and address of the buyer if

the energy is sold; or (ii) a description of how the energy will be used by the Applicant if the energy produced will not be sold.

For purposes of determining the beginning of construction or placed in service dates, all the components of a larger property are treated as a single unit of property if the components are functionally interdependent.

Components are functionally interdependent if the placing in service of one component is dependent on the placing in service of the other component.

Conversely, 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 the units (and any property, such as a computer control system, that serves some or all such 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 example, a wind farm owner may elect to treat one independent wind turbine as being placed in service when that wind turbine meets the requirements for placement in service.

Recapture

If Applicant disposes of the specified energy property to a Disqualified Person or the property ceases to qualify as a specified energy property within five years from the date the property is placed in service, one-fifth of the Treasury Cash Grant must be repaid to the Treasury for every partial year the property ceases to qualify ("Recapture"). The Applicant must make an annual certification to Treasury that no Recapture has occurred.

Property is considered to have been disposed of to a Disqualified Person if any interest in: (i) the property; (ii) the Applicant; or (iii) in any partnership or pass-thru entity that is a direct or indirect owner of an interest in the Applicant is sold to a Disqualified Person. Disposing of the property to an entity other than a Disqualified Person does not result in Recapture provided

the property continues to qualify as a specified energy property and provided the purchaser of the property agrees to be jointly liable with the Applicant for any Recapture. Therefore, Applicant remains jointly liable to the Treasury for the Recapture amount even if the Applicant no longer has control over the property.

Property ceases to qualify as a specified energy property if the use of the property changes so that it no longer qualifies as specified energy property.

Temporary cessation of energy production will not result in Recapture provided the Applicant intends to resume production at the time production ceases. Permanent cessation of production will result in recapture. If the amount of the Treasury Cash Grant depends on the percentage of electricity produced or the energy efficiency percentage, and this percentage is reduced, a proportionate percentage of the property ceases to qualify as specified energy property.

Recapture amounts repaid to the Treasury are considered debts owed to the United States and if not paid when due, will be collected by all available means against any assets of the Applicant.

Other Requirements

A lessor who is eligible to receive a Treasury Cash Grant with respect to a property may elect to pass-through the Treasury Cash Grant to a lessee. The lessee must be eligible to receive a Treasury Cash Grant and must agree to include ratably in gross income over the five-year Recapture period an amount equal to 50% of the amount of the Treasury Cash Grant. In a sale-leaseback transaction, the lessee must be the person who originally placed the property in service and the lessee and lessor must not make an election to preclude the application of the sale-leaseback rules. The property must be sold and leased back by the lessee, or must be leased to the lessee, within three months after the date the property was originally placed in service.

The lessor is liable to the Treasury for the Recapture amount even if the lessee maintains control over the property.

Applicant may submit, along with their request for payment, a notice of assignment, assigning the payment to a third party provided the requirements

of the Federal Assignment of Claims Act (31 U.S.C. 3727) are met.

The Treasury, and its agents, shall have the right of physical access to the Applicant's facilities and to any pertinent books, documents, papers, or other records (electronic and otherwise)

of the Applicant and each partnership and pass-thru entity that directly or indirectly owns an interest in the Applicant which are pertinent to the Treasury Cash Grant, in order to conduct audits, examinations, and evaluations.

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