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Treasury Clarifies 5 Percent Safe Harbor Ownership Guidelines for Section 1603 Grants for Renewable Energy Projects

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The Treasury Department has issued guidance in the form of two new "Frequently Asked Questions" addressing when transferees or purchasers of renewable energy property will qualify for the 5 percent safe harbor for beginning construction under the grant in lieu of investment credit program.

The U.S. Department of the Treasury has issued two new "Frequently Asked Questions" (Ownership FAQ) addressing when transferees or purchasers of renewable energy property (or entities owning renewable energy property) will be deemed to have "stepped into the shoes" of the prior owner for purposes of the 5 percent safe harbor under the grant in lieu of investment credits pursuant to Section 1603 of the American Recovery and Reinvestment Tax Act of 2009 (Grant). The Grant enables renewable energy projects to receive cash payments equal to 30 percent of the project's qualifying cost basis in lieu of investment tax credits. In order for a renewable energy project to be eligible for the Grant, the project must have been placed in service in 2009, 2010 or 2011, or have "begun construction" in 2009, 2010 or 2011. There are two ways to show that construction has begun for purposes of the Grant: actual physical work of a significant nature or satisfaction of the 5 percent safe harbor by paying or incurring more than 5 percent of the total cost of the project.

As discussed further below, the Ownership FAQ provide new guidelines for meeting the 5 percent safe harbor as a transferee of energy property that has met the 5 percent safe harbor or as a purchaser of an entity that has met the 5 percent safe harbor. View the Ownership FAQ (see Q23 and Q24). View additional reading on the Grant here.

Changes in Ownership of Energy Property

Question 23 of the Ownership FAQ asks, for purposes of the 5 percent safe harbor, what happens if ownership of energy property intended to qualify for the 5 percent safe harbor changes between the time the property is acquired for use in a project and the time the project is placed in service. The Treasury Department's answer to this question explains that, if a transferor contributes, assigns or transfers property to a transferee, and the transferee uses the property in a project, the transferee is treated, for purposes of the 5 percent safe harbor as having paid or incurred, at the same time as the transferor, the costs that the transferor paid or incurred for such property. However, this rule only applies if the transferor acquired the property for use in that project and is related to the transferee. A transferor will be treated as related to a transferee if the transferor and transferee are related persons within the meaning of section 197(f)(9)(C) of the Internal Revenue Code immediately before or immediately after the contribution, assignment or transfer of the property. Generally, under this rule, partners are related to partnerships if the partner owns, directly or indirectly, more than 20 percent of the capital interest in the partnership or more than 20 percent of the profits interest in the partnership. There does not appear to be any requirement that the transfer of energy property be done in a tax-free manner.

Prior to the issuance of the Ownership FAQ, Grant applicants and practitioners had received informal advice by way of Treasury Department e-mails and other correspondence indicating that energy property that had met the 5 percent safe harbor requirements could be contributed or assigned to affiliated entities in tax-free contribution transactions. The Ownership FAQ add some complexities to these transfers as it is not clear what is required to show that the transferor acquired the property for use in the specific project. The Treasury Department has indicated via the same set of FAQ that the specific site for a project does not need to be identified prior to the filing of an initial Grant application by the October 1, 2012, deadline for such filing. It is assumed the Treasury Department is not changing its position with respect to the need to identify a specific project location prior to the preliminary application date. Additionally, the Ownership FAQ generally require 20 percent ownership of the transferee by the transferor in the case of a contribution of energy property to a partnership. Prior to the issuance of the Ownership FAQ, practitioners may have assumed that ownership of some amount less than 20 percent may have sufficed so long as the contribution was a tax-free transfer under, for example, Section 721 of the Internal Revenue Code.

Question 23 also provides that, if property is sold to an unrelated purchaser after December 31, 2011, the purchaser may not take the costs the transferor incurred with respect to the property into account when determining whether the 5 percent safe harbor is met. Question 23 clarifies this limitation does not apply in the case of a sale/leaseback arrangement. If an entity that met the 5 percent safe harbor with respect to a facility sells the facility to an unrelated entity and leases the facility back from that entity within 90 days of the placed in service date, the purchaser of the facility (assuming all other eligibility requirements are met) would be treated as satisfying the 5 percent safe harbor. This piece of the guidance is generally familiar to Grant applicants and practitioners based on Treasury Department correspondence, although its appearance in Question 23 is the first time it has been set in Treasury Grant guidance.

Changes in Ownership of Entities Owning 5 Percent Safe Harbor Energy Property

Question 24 of the Ownership FAQ asks, for purposes of the 5 percent safe harbor, what happens if ownership of the entity that met the 5 percent safe harbor changes before the property is placed in service. The answer indicates that, if ownership of the entity that met the 5 percent safe harbor changes after December 31, 2011, and before the property is placed in service, eligibility is not affected if the purchaser is an otherwise eligible Section 1603 applicant and the entity being sold had commenced development of a project as evidenced by activity such as acquiring land, obtaining permits and licenses, entering into a power purchase agreement, entering into an interconnection agreement or contracting with an Engineering, Procurement and Construction Contractor. Further explaining this guideline, the Treasury Department notes the purchaser of an entity that holds equipment only may not rely on costs paid or incurred to acquire that equipment.

Prior to the issuance of Question 24, pursuant to informal correspondence with the Treasury Department, many Grant applicants and practitioners understood that ownership of project companies owning 5 percent safe harbor property could change prior to the underlying project being placed in service and such project companies would still be eligible for the Grant pursuant to the 5 percent safe harbor. Question 24 elaborates on this informal correspondence by requiring that the project company have commenced development of a project as evidenced by some development activity. The intent of Question 24 appears to be to prevent persons from purchasing renewable energy equipment eligible for the 5 percent safe harbor, contributing that equipment to project companies with no intent to develop an actual project and selling the project company to a third party presumably with a higher value due to the equipment's potential qualification for the Grant.

As an example, Question 24 provides the following:

A project company meets the safe harbor, and commences development of a project by acquiring permits, a power purchase agreement and an interconnection agreement. A partnership interest in the project company is sold to a tax equity investor (or the tax equity investor makes a capital contribution in exchange for a partnership interest) in a partnership flip transaction. The project company (with the tax equity investor as a partner) may rely on costs incurred by the project company to satisfy the 5 percent safe harbor. On the other hand, if a project company meets the safe harbor by purchasing and taking delivery of the equipment, but does no other activity, the purchaser of the project company may not rely on costs incurred by the project company to satisfy the 5 percent safe harbor.

The Ownership FAQ add some nuances and complexities to qualifying for the Grant pursuant to the 5 percent safe harbor. Potential Grant applicants may have to re-evaluate their plans for equipment or project companies that were intended to meet the 5 percent safe harbor if an ownership change of such property or project company may occur.

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