



UPDATE REPORT

THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 Grants in Lieu of Tax Credits for Renewable Energy

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INTRODUCTION

The American Recovery and Reinvestment Act of 2009 (the “Act”), often referred to as the Stimulus Bill, contains several provisions intended to provide incentives to developers and producers of renewable energy. Perhaps the most attractive renewable energy incentive in the Act is Section 1603, which allows taxpayers to elect to receive a grant, rather than a tax credit, when “specified energy property” is placed in service (the “Grant Program”).

Prior to the Act, the primary tax incentives offered to developers and producers of renewable energy consisted of tax credits based on renewable energy production or investment (the “Credits”). Because the value of the Credits is dependent upon having sufficient tax liability to offset, the current economic climate has made the Credits much less attractive to many investors. The Grant Program provides recipients with cash regardless of their tax liability.

When first announced, the lack of specific guidelines regarding the Grant Program caused a temporary freeze in the renewable energy market. On July 9, 2009, the Treasury Department (“Treasury”) released three documents intended to clarify any uncertainties about the Grant Program;

- 1) Application for Section 1603: Payments for Specified Renewable Energy Property in Lieu of Tax Credits (the “Application”),
- 2) Payments for Specified Energy Property in Lieu of Tax Credits under the American Recovery and Reinvestment Act of 2009 Terms and Conditions (the “T&C”), and
- 3) Payments for Specified Energy Property in Lieu of Tax Credits under the American Recovery and Reinvestment Act of 2009 Program Guidance (the “Guidance”).

The Application, T&C, and Guidance clarified much of the initial uncertainty regarding the Grant Program, but several questions still remain.

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THE GRANT PROGRAM

General Information

The Grant Program offers developers and investors a cash grant equal to the applicable percentage (“Applicable Percentage”) of the specified energy property’s basis. The specified energy property must (1) be placed in service in 2009 or 2010, or (2) be placed in service by the “credit termination date” if construction on the project began in 2009 or 2010.

The credit termination date depends on the type of specified energy property and varies from January 1, 2013 to January 1, 2017. When defining specified energy property, the Guidance does not stray from the definitions given in Sections 45 and 48.¹ To the extent the precise definition of “specified energy property” impacts (1) the Applicable Percentage or (2) the length of the period during which a developer or investor can qualify under the Grant Program (i.e., “solar energy facility” vs. “solar energy property”), special attention must be given to whether the specified energy property fits within the particular definition providing a greater benefit to such developer or investor.

Eligible Recipients

Generally, those persons that qualify for the Credits will also qualify for the Grant Program. However, federal, state and local governments, tax-exempt organizations, and qualified issuers of clean renewable energy bonds are ineligible to receive cash under the Grant Program (collectively, the “Disqualified Parties”). Further, partnerships and other pass-through entities with Disqualified Parties as direct or indirect partners or owners will also be ineligible to

receive grants.² Therefore, projects with private equity funds or other pass-through investors should pay particular attention to the rules for applicant eligibility. Applicants who may be affected by Disqualified Parties should seek advice regarding setting up a “blocker” corporation to retain their eligibility. The Guidance provides that a REIT may serve as a “blocker corporation.”

Timing of Grant Payments

Grants for property placed in service in 2009 or 2010 will be paid within 60 days of Treasury’s receipt of the Application. Generally, property is considered “placed in service” when the property is placed in a condition or state of readiness and availability for a specifically designed function. However, decades of case law and Internal Revenue Service guidance has interpreted the meaning of “placed in service” in various contexts, so the facts of the transaction need to be considered when determining whether all or a portion of the facility has been “placed in service.”

If construction on the property begins in 2009 or 2010, but the property is placed in service after 2010, applicants will have 90 days after the property is placed in service to provide Treasury with any information necessary to complete the Application (e.g., cost basis) (the “Supplemental Information”). Grants for such property will be paid within 60 days after Treasury receives the Supplemental Information. Leaving the cost basis section of the Application blank prevents the potential pitfalls of estimation -- recapture in the case of over-estimation and not receiving the full grant the applicant is entitled to in the case of under-estimation.

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Construction is considered to begin when “physical work of a significant nature” begins. Preliminary activities such as planning, designing, securing financing, exploring, or researching do not qualify as physical work. The Guidance includes a safe harbor stating that physical work of a significant nature begins when the applicant incurs or pays more than 5% of the total cost of the property.³ The Guidance does not address the consequences of underestimating the total cost of the property when taking advantage of the safe harbor. Parties should consider the rules discussed in the next section when assessing whether they meet this 5% standard as application of those rules may provide some flexibility.

Units of Property

A unit of property consists of all components of a larger property that are “functionally interdependent,” where placing one component in service is dependent upon placing the other component in service.⁴ The owner of multiple units of property that are located at the same site and that will be operated as a larger unit (e.g., a wind farm) may elect to treat the units as a single unit of property when determining the beginning of construction and the date the property is placed in service.⁵ Making such an election might ease the pressure to make the tax equity investor a partner in a partnership flip deal before the project is placed in service.

Investors will need to weigh the benefits of receiving a larger grant by including additional

units in a single unit of property against prolonging the “placed in service” date and the receipt of cash. Investors should also consider the risk of not completing the entire project by the deadline, thereby decreasing the amount of the grant received. Further, as alluded to in the last section, expanding or contracting the size of the project under these unit rules may aid in meeting the 5% “physical work” test.

Recapture

A percentage of the grant will be “recaptured” by the Internal Revenue Service if the specified energy property ceases to be specified energy property within five years. The amount “recaptured” is staggered based on the year in which such “recapture” takes place. However, unlike the recapture rules for investment credits, a disposition of specified energy property will not automatically trigger “recapture.” The government will not “recapture” the grant money if (1) the property is sold or otherwise disposed of to an entity other than a Disqualified Party, (2) the property continues to qualify as specified energy property, and (3) the purchaser of the property agrees to be jointly liable with the applicant for any recapture.

Recapture liabilities are not considered tax liabilities.⁶ As a result, various provisions of the Code applicable to penalties and tax liens do not apply to grant monies. However, the Guidance states that “funds that must be repaid to the Treasury under these rules 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, including enforcement by the United States Department of Justice.”⁷

Assignment of Grant Payment

Grant payments are assignable to third parties.⁸ Applicants are instructed to submit a Notice of Assignment with their request for payment. While the Guidance does not expressly prohibit assignment of payments to Disqualified Parties, the blanket prohibition on Disqualified Parties receiving payments under the Grant Program likely prevents such assignments.

Treasury Oversight

A notice issued by Treasury before July 9, 2009 established that Treasury will monitor and review projects receiving grants under the Grant Program. Without additional explanation, Treasury announced plans to monitor “percent on-time performance for project activities; obligations and outlays; acquisition competition and contract types; performance measure actual values versus targets; and accountability metrics monthly,” and that “corrective and/or preventative actions that are established as a result of the reviews will be tracked for implementation.” These concepts are not defined and no examples of their application currently exist. The Application, T&C, and Guidance do not shed any additional light on the subject. Therefore, it is unclear how and to what extent Treasury’s monitoring will impact energy projects. Further adding to the uncertainty, Treasury conceded that it “has little

experience in administering energy related programs . . . [and] it will need to rely on the expertise of the Energy Department to assist in administering the program.”⁹

CONCLUSION

Many questions surrounded the Grant Program prior to the release of the Application, T&C, and Guidance, resulting in a freeze of the renewable energy market. Perhaps the biggest cause for the freeze was the market’s uncertainty regarding Treasury’s admitted lack of expertise administering energy-related programs.¹⁰ While Treasury’s inexperience in the renewable energy arena remains, it should be the case that the Guidance will thaw the market, since significant concessions have been made.

Specified Energy Property	As Defined in I.R.C. * Section	Applicable Percentage ^{***}	Credit Termination Date ^{***}
Wind Facility	§45(d)(1)	30%	1/1/2013
Biomass Facility (Closed-Loop and Open-Loop)	§45(d)(2)-(3)	30%	1/1/2014
Solar Energy Facility	§45(d)(4)	30%	1/1/2014
Geothermal Energy Facility	§45(d)(4)	30%	1/1/2014
Landfill Gas or Trash Facility	§45(d)(6)-(7)	30%	1/1/2014
Qualified Hydropower Facility	§45(d)(9)	30%	1/1/2014
Marine and Hydrokinetic Renewable Energy Facility	§45(d)(11)	30%	1/1/2014
Qualified Small Wind Energy Property	§48(c)(4)	30%	1/1/2017
Qualified Fuel Cell Property**	§48(c)(1)	30%	1/1/2017
Solar Property	§48(a)(3)(A)(i)-(ii)	30%	1/1/2017
Qualified Microturbine Property **	§48(c)(2)	10%	1/1/2017
Combined Heat and Power System Property**	§48(c)(3)	10%	1/1/2017
Geothermal and Geothermal Heat Pump Property	§48(a)(3)(A)(iii), (vii)	10%	1/1/2017

* All references to “I.R.C.” “Section” and “§” are to the Internal Revenue Code of 1986, as amended, and the Treasury regulations promulgated thereunder.

** The Grant Program imposes the same dollar limitation as §48 imposes on credits for the specified property.

*** To the extent the definitions of “geothermal” and “solar” are similar under §§45 and 48, the precise definition is important in determining (1) the Applicable Percentage and (2) the credit termination date. For example, if solar specified energy property qualifies for a credit termination date in 2014 and 2017, the credit termination date will be 1/1/2017.

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- 1 All references to “I.R.C.” “Section” and “§” are to the Internal Revenue Code of 1986, as amended, and the Treasury regulations promulgated thereunder.
- 2 Guidance at p.4.
- 3 Guidance at p.6-7.
- 4 Guidance at p.7.
- 5 Guidance at p.7.
- 6 T&C at p.2.
- 7 Guidance at p.19.
- 8 Guidance at p.19. Assignments must satisfy the requirements of the Federal Assignment of Claims Act. See 31 U.S.C. 3727.
- 9 <http://www.treas.gov/recovery/> (follow “ARRA Program Plan – Cash Assistance for Specified Energy Property in Lieu of Tax Credits” hyperlink).
- 10 Id.

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