Treasury Updates Section 1603 Cash Grant Guidance and Frequently Asked Questions

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The U.S. Treasury Department recently provided clarifications to the existing guidance relating to the cash grant in lieu of the investment tax credit for renewable energy projects.

On April 13, 2011, the U.S. Department of Treasury posted updated guidance (Guidance) and updated Frequently Asked Questions (FAQ) with respect to the Section 1603 cash grant in lieu of investment tax credits created by the American Recovery and Reinvestment Act of 2009. The grant permits certain renewable energy projects to receive a cash grant from the Treasury equal to 30 percent of the qualified costs (and 10 percent for other renewable energy projects). On December 16, 2010, the grant was extended to apply to projects placed in service in 2011 or projects on which construction was begun in 2011. See Congress Passes Bill Extending Section 1603 Grant and Other Energy-Related Incentives for additional grant qualification information and the extension.

The changes to the Guidance and FAQ relate to a mix of topics discussed below. The Treasury has also summarized some of the changes to the Guidance here. Many of the changes related to updating the applicable dates in the Guidance and FAQ to reflect that the grant was extended through 2011. These changes are generally not discussed herein.

Changes to "Beginning of Construction Guidance"

In order for property placed in service after 2011 to qualify for the grant, construction of the property must have begun during 2009, 2010 or 2011. The Guidance provides a safe harbor for applicants to be deemed to have begun construction in 2011 if such applicant has incurred or paid more than 5 percent of the total cost of the project. See Treasury Issues Guidance on "Beginning Of Construction" for 1603 Grants for detail on this safe harbor. The updated Guidance revises the 5 percent safe harbor rules by removing the language that previously excluded the "cost of any land and preliminary

activities such as planning, designing, securing financing, exploring, or researching" from the 5 percent calculation.

If an applicant does not meet the safe harbor, the applicant can demonstrate that "physical work of a significant nature has begun" in order to show that construction began during 2009, 2010 or 2011. In this case, physical work of a physical nature does *not* include preliminary activities such as "planning or designing, securing financing, exploring, researching, clearing a site, test drilling of a geothermal deposit, test drilling to determine soil condition, or excavation to change the contour of the land."

Elimination of Requirement that Property Be Located at a Single Site

The updated Guidance eliminates the requirement that qualified property be located onsite at the renewable energy project location. Previously, the Guidance and FAQ had provided that only property located at the site of the project could be included as "specified energy property" eligible for the grant. Therefore, potentially eligible property must only be "an integral part of the qualified facility" in order to qualify as "specified energy property" eligible for the grant. Pursuant to the Guidance, property is generally an integral part of a qualified facility if the property is used directly in the qualified facility and is essential to the completeness of the activity performed in that facility.

Revised Explanation of "Qualified Facility Property"

The updated Guidance revises the description of property that is eligible under Section 45 of the Internal Revenue Code (Code). "Qualified Facility Property" is now defined as property that is an integral part of a qualified facility described in Code Section 45(d)(1), (2), (3), (4), (6), (7), (9) or (11), which encompasses the facilities using the following renewable energy sources: wind, closed-loop biomass, open-loop biomass, geothermal or solar, landfill gas, trash, qualified hydropower, and marine and hydrokinetic sources. The updated Guidance clarifies (in part by defining a qualified facility by reference to Section 45 as described in the previous sentence) that Qualified Facility Property must be part of a facility that meets the placed-in-service requirements of Code Section 45.

This change and the removal of language in the Guidance providing that generally, "a qualified facility must be capable of operating as an independent unit even though the property is installed at the site of an existing facility" confirms that modifications to

existing facilities may qualify for the grant if the facility has otherwise met the placed in service requirements of Code Section 45. Thus, Qualified Facility Property may be a post-2008 addition to or modification of a facility placed in service before 2009, so long as the facility meets the placed-in-service-requirements of Code Section 45. If a grant payment is made on a post-2008 modification of a property placed in service before 2009, no credit is allowed with respect to such facility under Code Sections 45 or 48 in that year or any subsequent year.

Qualifying Biomass Property Clarified

Additionally, the updated Guidance provides that if a qualified facility uses gas or liquid derived from open-loop biomass, closed-loop biomass or municipal solid waste to produce energy, the equipment used to produce or process such gas or liquid may be an "integral part of the qualified facility." The updated FAQ further clarify this equipment may be "under different ownership or at a different site."

However, the updated Guidance also limits the type of property that can be included in a qualifying biomass facility. The guidance provides that qualifying property does not include "equipment used to cultivate closed-loop biomass, equipment used to collect open-loop biomass, closed-loop biomass, or municipal solid waste, and trucks, railroad cars, barges and pipelines that transport open-loop biomass, closed-loop biomass, or municipal solid waste (or a gas or liquid produced from any of the foregoing) to a qualified facility or between noncontiguous parts of a qualified facility."

Limitation on Eligible Basis

The Guidance states that the eligible basis of a qualified facility does not include the portion of the cost of the facility attributable to a non-qualifying activity. The updated Guidance removes the language that states this limitation on eligible basis "does not reduce the eligible basis of a facility that qualifies as a modification of an existing facility." Instead, the updated Guidance provides that, if costs are attributable to both a non-qualifying activity and a qualifying activity, "the costs must be reasonably allocated between the nonqualifying and qualifying activities."

Updated FAQ

The Treasury added new questions and answers (numbered 32 to 37) to the FAQ, summarized below.

- If components of a facility are owned by different persons, each owner must submit a separate application for a grant. However, all owners of the facility must join in each separate application (including owners of portions of the facility not eligible for the Grant) and agree to the terms and conditions, including the waiver of the right to claim a production tax credit with respect to the facility.
- Dead and diseased trees resulting from pine beetle infestation qualify as open-loop biomass if they have no other commercial value.
- A facility that produces energy from pyrolysis oil can qualify as an open-loop biomass facility.
- "Conversion equipment" that is an integral part of a qualified facility may qualify for the grant if the facility's combustion equipment was placed in service before 2009. However, the conversion equipment must have been placed in service in 2009–2011 (or will be placed in service in 2012 or 2013 for equipment on which construction begins in 2009–2011). Therefore, conversion equipment may be placed in service at a later date than the original facility and still be considered an integral part of the facility for grant purposes.
- Conversion equipment used to convert open-loop biomass, closed-loop biomass or municipal solid waste into a gas or liquid for use in a qualified facility may qualify for a grant. However, this equipment must be "integrated" into the qualified facility. Typically, this equipment is owned by the same person and located at the same site as the qualified facility. However, if the equipment is owned by a different owner, or located at a different site, the Treasury will consider several factors to determine whether the conversion equipment is "integrated" into the qualified facility, including:
    - Whether the conversion equipment and the facility are placed in service simultaneously
    - The extent to which the gas or liquid converted is dedicated to the facility (if less than 75 percent of the gas or liquid produced is dedicated to the facility, then the conversion equipment will generally not be treated as dedicated to the facility)

- The dependence of the facility on the gas or liquid produced by the particular conversion equipment

- The eligible cost basis of conversion equipment is not required to be reduced for grant purposes if the qualifying facility (of which it is an integral part) burns fuel other than fuel that the conversion equipment produces from qualified energy resources. However, all of the fuel produced by the conversion equipment must be used by the qualifying facility in the production of electricity.

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