WSGR ALERT

MARCH 2010

TREASURY DEPARTMENT RELEASES REVISIONS TO GUIDANCE FOR GRANT PROGRAM

On July 9, 2009, the Treasury Department released guidance (the July 2009 guidance) and application materials for the cash-grant program enacted in Section 1603 of the American Recovery and Reinvestment Act of 2009, P.L. 111-5. While generally very helpful, some portions of the July 2009 guidance were not entirely clear, making it difficult in some cases for developers to know whether certain construction activities would be sufficient to make their projects eligible for the grant even though the project would not be completed until after 2010 (when the grant provisions would no longer apply under current law). To resolve certain questions that have arisen since the July 2009 guidance was issued, the Treasury Department today released revisions that clarify the determination of when construction has begun for qualifying property placed in service after 2010 (including the application of the "safe harbor" in the July 2009 guidance). Other than changes to Section IV.C regarding beginning of construction, the July 2009 guidance has not been revised. A grant applicant may choose to determine when construction begins under the July 2009 guidance, rather than under the revised guidance.

The following link can be used to access the revisions to the July 2009 guidance, as revised ("Payments for Specified Energy Property in Lieu of Tax Credits under the American Recovery and Reinvestment Act of 2009," or the revised guidance) and the application (including Terms and Conditions): http://www.treas.gov/recovery/1603.shtml. Our July 2009 WSGR Alert discussing the original Treasury guidance may be accessed here: http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/PDFSearch/wsgralert_section1603.htm.

Background

The grant program allows owners and certain lessees of specific types of renewable energy property to receive a cash grant of, generally, 30 percent of the cost of the property in lieu of claiming a tax credit [either the Production Tax Credit (PTC) or the Investment Tax Credit (ITC)] with respect to the property. The grant program was enacted in response to the declining pool of investors with sufficient taxable income to currently utilize the ITC or PTC, and in many ways functions as a surrogate for those credits. For example, grants are not taxable income for federal income tax purposes (state treatment may differ) and the basis of the property with respect to which a grant was paid generally must be reduced by 50 percent of the grant. The grant is available for property placed in service in 2009 or 2010, or property placed in service after 2010 (and before the expiration date of the credit available for the property) so long as construction of the property began in 2009 or 2010.

Beginning of Construction

General. If property will be placed in service after 2010, the applicant must demonstrate that construction of the property began during 2009 or 2010. According to the July 2009 guidance, construction of property begins "when physical work of a significant nature begins." The revised guidance adds some color to the meaning of "physical work of a significant nature" by providing that one can take into account both on-site work and off-site work. For example, in the case of a wind turbine, on-site physical work of a significant nature begins "with the beginning of excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation." If the turbines are to be assembled on-site from components manufactured off-site, "physical work of a significant nature begins when the manufacture of the components begins at the off-site location." If a manufacturer produces components for multiple facilities, the revised guidance requires that "reasonable methods" be used to associate individual components with particular facilities. As in the July 2009 guidance, "physical work of a significant nature" does not include "preliminary activities" like "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 (as distinguished from excavation for footings and foundations)." The revised guidance clarifies that test drilling for geothermal deposits is not considered the beginning of construction, apparently to resolve concerns that test drilling before 2009 might make a geothermal project ineligible for a grant.

Self-Constructed Property. For an applicant that manufactures, constructs, or produces property for use in the applicant's trade or business (or for its production of income), the work performed by the applicant is taken into account to determine when physical work of a significant nature begins.

Construction by Contract. For property manufactured, constructed, or produced for the applicant by another person under a written binding contract entered into before the manufacture, construction, or production of the property for use by the applicant in its trade or business (or for its production of income), the work performed under the contract is taken into account to determine

Continued on page 2...

Treasury Department Releases Revisions . . .

Continued from page 1...

when physical work of a significant nature begins. The July 2009 guidance contains a number of rules regarding whether a contract is "binding"; those rules have not been changed in the revised guidance, other than to clarify that minor modifications to the property's design specifications (such as a cold-weather package for wind turbines) do not affect the binding nature of the contract.

Safe Harbor. The most important changes made by the revised guidance are in the "safe harbor" rules. Under the July 2009 version of the safe harbor, (i) an applicant may treat physical work of a significant nature as beginning when 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 total cost of the property (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching), and (ii) when the property is being manufactured, constructed, or produced by another person, the applicant (not the counterparty) must meet the safe harbor. The revised guidance substantially modifies both of these rules.

In the case of an accrual-basis applicant, the July 2009 guidance provided that the economic-performance rules of Section 461(h) of the Internal Revenue Code apply, which created some uncertainty as to when an accrual-method taxpayer had incurred an amount for purposes of the safe harbor. While the revised guidance's safe harbor retains the "more than 5 percent of total costs" hurdle, it appears to eliminate the use of the economic-performance rules for accrual-basis applicants and provides generally that an applicant "may treat physical work of a significant nature as beginning when more than 5 percent of the total cost of the property has been paid or incurred." Elimination of the economic-performance rules from the safe harbor would be consistent with our informal discussions with the Treasury Department. Under the revised guidance, it also appears that an applicant's inclusion of costs toward the safe harbor does not depend on the applicant's tax accounting method, and that any cost that has either been paid or incurred will count.

When the property is being manufactured by another person, the property's cost is treated as paid or incurred either (i) when the property is provided to the applicant or (ii) for periods before the property is provided to the applicant, when costs are paid or incurred by the other person (i.e., the manufacturer). Allowing costs paid or incurred by the manufacturer to be counted toward the safe harbor is a favorable modification, because the applicant might not have paid or incurred costs for the property before it is delivered. If the property includes both self-constructed components and components manufactured under a contract, costs relating to both types of components are combined to determine if 5 percent of total costs have been exceeded.

The revised guidance clarifies that only costs included in the property's basis eligible for the grant are included for purposes of determining if the safe harbor has been satisfied, and also provides that for property that will be leased in a transaction in which the lessor elects to pass the credit to the lessee (other than a sale-leaseback), the safe harbor must be met by the lessor.

Please contact Mike Faber (mfaber@wsgr.com or 212-497-7757), Greg Broome (gbroome@wsgr.com or 415-947-2139), or Andrew Bryant (abryant@wsgr.com or 206-883-2512) in Wilson Sonsini Goodrich & Rosati's tax practice with any questions.

WSGR

Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

This WSGR Alert was sent to our clients and interested parties via email on March 15, 2010. To receive future WSGR Alerts and newsletters via email, please contact Marketing at wsgr_resource@wsgr.com and ask to be added to our mailing list.

This communication is provided for your information only and is not intended to constitute professional advice as to any particular situation. We would be pleased to provide you with specific advice about particular situations, if desired. Do not hesitate to contact us.

650 Page Mill Road
Palo Alto, CA 94304-1050
Tel: (650) 493-9300 Fax: (650) 493-6811
email: wsgr_resource@wsgr.com

www.wsgr.com