Treasury Issues Guidance for Cash Grant Program for Qualifying Renewable Energy Projects

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On July 9th, the U.S. Treasury Department published guidance ("Guidance Materials") for applicants seeking cash grants for qualifying renewable energy projects pursuant to Section 1603 of the American Recovery and Reinvestment Act of 2009 ("ARRA"). This alert provides an overview of key provisions of the Guidance Materials. Although not stated in the Guidance Materials, Treasury personnel have said that they expect to begin accepting web-based grant applications on or about August 1, 2009. If you are intending to apply for a cash grant, we encourage you to carefully review the Guidance Materials and begin preparation of the grant application in consultation with legal counsel and engineering professionals.

The Treasury Cash Grant Program - Overview

The new (and temporary) cash grant program provides an alternative for businesses that could otherwise claim the Production Tax Credit ("PTC") or the Investment Tax Credit ("ITC") for certain qualifying renewable energy projects.

The amount of a cash grant for a qualifying project will equal either 10% or 30% of the eligible cost basis of the project, depending on the type of renewable energy technology used and subject to certain maximum payments for particular technologies. The receipt of a cash grant will not be taxable for federal income tax purposes (except with respect to certain leased property, as further described below). However, the depreciable cost basis of the project will be reduced by 50% of the amount of the cash grant (except in the case of certain leased property).

Although Treasury estimates as much as $3 billion will be paid out as cash grants, there is no limit on the total amount of the cash grants that may be made under this program.

"In Lieu Of" the PTC or ITC

A taxpayer cannot claim the PTC or the ITC for a project that receives a cash grant from Treasury. In this sense, the cash grant program is generally described as being "in lieu of" the PTC and the ITC. However, it is clear from the Guidance Materials that the term "in lieu of" should not be interpreted to mean that a renewable energy project will have to satisfy all the requirements applicable to the PTC or ITC in order to qualify for a cash grant. On the contrary, the Guidance Materials establish that the cash grants will be subject to more liberal qualification rules in some important respects, including liberalized recapture rules (discussed below in "Guidance Regarding Eligibility for Cash Grants") and the lack of any stated requirement that a project sell its energy output to unrelated third parties (also discussed below). These liberalized requirements will support modified and simplified transaction structures and business arrangements for financing and investing in qualifying renewable energy projects and enable on-site, user-owned renewable energy projects to receive cash grant funding.

Timeframe for Application Filing

For property placed in service in 2009 or 2010, applications must be submitted after the property has been placed in service and before October 1, 2011. For property not placed in service in 2009 or 2010 but for which construction commences in 2009 or 2010, applications must be submitted after construction commences and before October 1, 2011. As previously indicated, grant applications are not yet being accepted, but Treasury personnel have stated that they expect to begin accepting web-based grant applications on or about August 1, 2009.

Timeframe for, and Form of, Payment of Cash Grants

For property placed in service in 2009 or 2010, applicants are to receive payment of their cash grants within 60 days after the submission of a completed application. In the case of applications for property that is not placed in service in 2009 or 2010 but for which construction timely commences, Treasury will review the application and notify the applicant if all eligibility requirements that can be determined prior to the property being placed in service have been met. If so notified, applicants must then submit, within 90 days after the date the project is placed in service, supplemental information sufficient for Treasury to make a final determination. Treasury will conduct a final review at that time and make payment to qualified applicants within 60 days after the supplemental information is received by Treasury.

In cases where an applicant has not submitted sufficient information upon which a determination can be based, the applicant will be notified and given 21 days from the date of notice to submit additional information. If additional information is not received in the 21-day period, the application will be denied.

Payments of cash grants will be made by Electronic Funds Transfer based upon the banking information provided by the applicant.

Application Form

The 2-part sample application package released on July 9th consists of a 6-page “Application for Section 1603” form, along with an additional 3-page “Terms and Conditions” form.

Applicants will be required to submit an executed “Application for Section 1603” form and signed “Terms and Conditions” form and to provide additional evidence that the renewable energy project is eligible for the cash grant and that it has been placed in service. To satisfy the additional evidence requirements, applicants will be required to provide (i) final engineering design documents stamped by a licensed professional engineer, (ii) equipment manufacturer documentation as to nameplate capacity or other documentation applicable to the particular type of renewable energy project, as specified in the Guidance Materials, (iii) evidence of approved grid interconnection (if interconnection is required), (iv) a commissioning report, (v) documentation to support the cost basis claimed for the specified energy property, including a detailed breakdown of all costs included in the basis of such property and (vi) an independent accountant's certification as to the cost basis of the specified energy property if the cost of such property exceeds $500,000.

Applicants submitting applications based on commencement of construction and later placement in service will be required to submit paid invoices and/or other financial documents demonstrating that physical work of a significant nature has timely begun on the property (including evidence of payments sufficient to satisfy the "more than 5%" safe harbor, as further discussed below). If the property is being manufactured, constructed or produced for the applicant by another person, the application must provide a copy of a binding contract for the manufacture, construction or production of the property that satisfies the requirements described in the Guidance Materials.

Applicants also will be required to obtain a DUNS number from Dun and Bradstreet and to register with the federal government's Central Contractor Registration ("CCR"). The Guidance Materials provide additional instructions as to how an applicant can obtain a DUNS number and register with the CCR.

Significantly, the Guidance Materials specify that receipt of the cash grant does not render the project subject to the National Environmental Protection Act's environmental impact review requirements nor to the prevailing wage requirements of the Davis-Bacon Act.

Guidance Regarding Eligibility for Cash Grants

Eligible Taxpayers

An applicant must be either the owner or lessee of the renewable energy project and must be the entity or person who originally placed it in service. If a lessee is the applicant, both the owner and the lessee must be eligible for the cash grant and the lessor-owner may not be any one of certain types of entities specified in the Guidance Materials. In addition, the owner and lessee of the project must both agree to the lessee's receipt of the cash grant and the waiver of the owner's right to receive a cash grant, ITC or PTC with respect to such project. The lessee must also agree to include ratably in gross income over the 5-year recapture period an amount equal to 50% of the amount of the cash grant payment received. The owner's and the lessee's agreement with respect to the election to pass-through the cash grant to the lessee must be included with the lessee's original application for the grant. Special rules apply to sale-leaseback transactions.

Certain non-U.S. persons and governmental and nonprofit entities are ineligible for cash grants. Similarly, partnerships and other pass-through entities that directly or indirectly include such entities as a partner or other holder of an equity or profits interest also will be ineligible. However, non-U.S. persons and governmental and nonprofit entities may indirectly hold interests in a project as shareholders in a taxable "C corporation."

Eligible Property

The Guidance Materials provide a detailed summary of the types of property that can be eligible to receive cash grants. In general, property eligible to receive cash grant payments is "specified energy property." The Guidance Materials describe the requirements for property to qualify as "specified energy property" and describe the types of renewable energy facilities that are eligible for participation in the cash grant program.

Placed-in-Service Requirements

Applicants that have originally placed in service eligible specified energy property at any time between January 1, 2009 and December 31, 2010 may apply for and receive cash grants. In addition, an otherwise qualifying project that is originally placed in service after December 31, 2010 can also qualify for a cash grant if construction on the project commences between January 1, 2009 and December 31, 2010 and the project is actually placed in service by the applicant before the applicable credit expiration date for the particular type of project, as listed in the Guidance Materials.

Placed-in-service has the same meaning for purposes of the cash grant program as for the ITC and generally means that the property is ready and available for its specific use. The original use of the property must begin with the applicant. If the cost of the used parts contained within a facility is not more than 20% of the total cost of the facility (whether acquired or self-constructed), an applicant will not fail to be considered the original user of property because the facility contains used parts.

Commencement of construction is defined in the Guidance Materials as "when physical work of a significant nature begins" and includes a safe harbor set at incurring (in the case of an accrual basis applicant) or paying (in the case of a cash basis applicant) more than 5% of the total cost of the property. Commencement of construction does not include incurring or paying costs of land, planning, designing, financing or researching a project. When property is manufactured, constructed or produced for the applicant by another person, the "more than 5%" test must be met by the applicant, not the other person. For purposes of satisfying the "more than 5%" safe harbor, equipment procurement and construction contracts will need to be carefully drafted to satisfy certain requirements related to their liquidated damages, design specifications and other provisions.

Eligible Basis

The eligible basis of property will be determined in accordance with the general rules for determining the basis of property for federal income tax purposes. Accordingly, the basis of property generally will be its cost, unreduced by any other adjustments to basis, such as that for depreciation, and will include all items properly included by the taxpayer in the depreciable basis of property, such as installation costs and the cost of freight incurred in the construction of the property. Only the cost basis of property that is placed in service after 2008 is eligible for the cash grant. In addition, the eligible basis of a qualifying project does not include the portion (if any) of the cost of the project that is attributable to a non-qualifying activity.

Modified Recapture Rules

A recipient of a cash grant may dispose of eligible equipment and sell interests in applicant project entities during the first 5 years of a project's operation without triggering recapture of the cash grant, so long as the transferee of the equipment (i) would itself meet the eligibility requirements imposed on cash grant applicants and (ii) agrees to be jointly liable with the transferor for any recapture. By contrast, persons receiving the ITC generally trigger recapture of all or a portion of the ITC upon a sale of the equipment or upon a change in control over the project entity owning the equipment within 5 years of the equipment's placed-in-service date. Cessation of operations or a change in the use of the property during the initial 5-year period may still result in recapture of the cash grant; however, the liberalization of the recapture rules in the Guidance Materials will allow more flexibility in the financing and structuring of qualifying renewable energy projects.

No Requirement for Sale of Energy to Third Party

Owners of equipment eligible for PTCs (such as wind turbines) are required to sell the project's output to an unrelated third party in order to qualify for the PTC. Although a literal reading of the statutory language of the ARRA relating to the cash grant program does not encompass this "sale to third party" requirement, some industry experts have been concerned that this requirement would nevertheless apply to the cash grant program since the program generally is described as providing for a cash grant "in lieu of" the PTC. The Guidance Materials, consistent with the statutory language, contain no such "sale to third party" requirement. Accordingly, business owners of their own on-site wind turbines and other specified PTC-eligible energy generation equipment should be comfortable that their business may qualify for cash grants even if the business itself consumes the equipment's energy output.

Location of Property

Property which is predominantly used outside the United States will not qualify for a cash grant. For this purpose, if property is located outside the United States during more than 50% of a given year, then such property is considered to be used predominantly outside the United States during that year.

Units of Property; Qualifying Property Installed on Other Property

The Guidance Materials provide an explanation of how separate units of property may be treated as a single unit for purposes of the cash grant program. The Guidance Materials also address how property eligible for the cash grant program is determined when the property is installed on other property.

Ongoing Requirements After Receipt of Cash Grant

A cash grant recipient will be required to provide periodic reports to Treasury, as Treasury may deem necessary. During the first 5 years of a project's operation, cash grant recipients will be required to certify annually as to the actual annual energy production of the specified property as well as the continued eligibility of the property and ownership by eligible persons. Treasury and the Comptroller General of the United States will have the right of physical access to the applicant's facilities and to the books and records of the applicant and any person or entity that directly or indirectly owns an interest in the applicant. Treasury will also reserve the right to release information about the applicant, the eligible project and the amount of the cash grant. Noncompliance with the terms and conditions of the application can result in disallowance of all or part of the cash grant received.