

Department of the Treasury Releases Guidance Establishing Application Procedures and Eligibility Requirements for Grants for Specified Renewable Energy Property in Lieu of Tax Credits

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On July 9, 2009, the Department of the Treasury released guidance (the Guidance) establishing the procedures for applying for grants in lieu of tax credits for investments in certain renewable energy property. The Guidance addresses a number of questions regarding the requirements that must be met in order to qualify for such grants, and provides rules relating to recapture of grant payments. Some of the more notable items from the Guidance are that:

- The recapture rules applicable to the grant program are more liberal than those applicable to the investment tax credit and, thus, most transfers should not trigger recapture of grant payments.
- Lessors that are eligible for grant payments may elect to allow a lessee to claim the grant payment.
- For purposes of determining when property is placed in service and construction begins, an applicant may elect to treat multiple units of property located and operated together as a single unit of property.
- The Guidance includes detailed rules, and a safe harbor, for determining when construction of a project is considered to have begun.
- The Department of the Treasury intends to begin accepting grant applications on or around August 1, 2009.
- Grant payments may be assigned to lenders or other third parties.

Following is a brief summary of the background of the grant program and certain key aspects of the Guidance.

Background

On February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act of 2009 (the Act), which contained a number of energy-related tax provisions designed to make investments in renewable energy projects more economically attractive. In particular, the Act expanded the scope of the investment tax credit to include certain qualified facilities that are otherwise eligible for the renewable electricity production tax credit. In addition, because Congress recognized that recent market conditions may significantly undermine the effectiveness of the investment tax credit to attract potential investors to such projects, the Act also authorized the Secretary of the Treasury to provide grants in lieu of the investment tax credits that would otherwise be available. Although there is no limit on the number or amount of grants that may be

issued, officials at the Department of the Treasury have estimated that grants will be made with respect to approximately 5,000 renewable energy projects in an aggregate amount of approximately \$3 billion.

The Act provides some procedural guidelines for the grant program. For example, the Act requires that grant applications be filed with the Secretary of the Treasury prior to October 1, 2011, and that grants be paid within 60 days of the energy property being placed in service or, if later, 60 days of the filing of such application. In addition, the Act provides that grants will be provided only with respect to energy property (i) that is placed in service during 2009 or 2010 or (ii) the construction of which began during 2009 or 2010 (and that is placed in service before the end of the applicable tax credit period). The Act also provides that governments (and agencies and instrumentalities thereof), tax-exempt entities, clean renewable energy bond lenders, cooperative electric companies and pass-thru entities with respect to which any owner is one of the preceding (“ineligible applicants”) are not eligible for the grants.

The legislative history to the Act indicates that the grant program is intended to mimic the investment tax credit. For example, with respect to recapture, the Act provides that rules similar to those governing the recapture of investment tax credits shall be applied in the manner that the Secretary of the Treasury determines appropriate.

Procedures Established in the Guidance

The Guidance expands upon the procedural guidelines set forth in the Act, providing the following details regarding grant applications:

- **Submitting a Grant Application.** The Guidance provides that grant applications may be submitted online at <http://www.treasury.gov/recovery>. Grants will be provided only to applicants who submit a completed application. An application with respect to a particular renewable energy property generally will be considered completed only if it includes:
 - > a signed and complete application form;
 - > a signed Terms and Conditions statement;
 - > complete payment information;
 - > final engineering design documents relating to the property;
 - > a detailed breakdown of all costs included in the basis of the property; and
 - > other specified supporting documentation, including (i) for certain types of property, documentation demonstrating that the property meets eligibility requirements specified in section 45 or 48 of the Internal Revenue Code; (ii) for property that is part of a hydropower facility, applicable Federal Energy Regulatory Commission certifications and licenses; (iii) for property that has been placed in service, a report provided by the engineer, the property vendor or an independent third party certifying that the property has been installed, tested, and is ready and capable of being used for its intended purpose; (iv) for property that has not yet been placed in service, documentation establishing that construction of such property has begun; and (v) for property that has a basis in excess of \$500,000, an independent accountant’s certification attesting to the accuracy of all costs claimed as part of the basis of the property.

- When a Grant Application Must Be Submitted. The Guidance provides that, for property placed in service in 2009 or 2010, a grant application 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, applications must be submitted after construction has begun (which must occur during 2009 or 2010) and before October 1, 2011.

The online system for submitting grant applications is not yet available and, thus, the Department of the Treasury has not yet begun accepting grant applications. However, during a briefing held in conjunction with the release of the Guidance, government officials stated that the system will be available and the Department of the Treasury will begin accepting applications on or around August 1, 2009.

- Application Review Process. The Guidance provides that, for property placed in service in 2009 or 2010, a grant application will be reviewed and, if the applicant is eligible for a grant, payment will be made within 60 days from the date the completed application is received. For property not placed in service in 2009 or 2010, a grant application will be reviewed and the applicant will be notified if all eligibility requirements that can be determined prior to the property being placed in service have been met. If so notified, an applicant must submit, within 90 days after the date the property is placed in service, supplemental information sufficient for the Department of the Treasury to make a final determination with respect to the grant application. Payment will be made within 60 days from the date such supplemental information is received by the Department of the Treasury.

Eligibility Requirements Clarified in the Guidance

The Guidance clarifies certain requirements that must be met in order to be eligible for such grants, including:

- Eligibility of Applicants That Are Pass-Thru Entities. As noted above, the Act provides that a pass-thru entity is not eligible for a grant if any owner of the pass-thru entity is an ineligible applicant. The Guidance clarifies this restriction by specifying that the ineligible applicant need not be a direct owner of the pass-thru entity in order to cause the pass-thru entity to be ineligible for a grant; indirect ownership (other than indirect ownership through a taxable C corporation) will be taken into account in this determination. Thus, the Guidance permits the use of blocker corporations and, accordingly, grant applicants should consult with their tax advisers regarding the proper use of blocker corporations as needed in the ownership structure in order to preserve eligibility for a grant.
- Time for Determining Eligibility of the Applicant. The Guidance provides that the determination of whether an applicant is eligible to receive a grant will be made as of the time the application is received. Thus, if a blocker corporation is needed in order to preserve eligibility for a grant, such blocker corporation should be in place prior to filing a grant application (however, such a blocker corporation does not necessarily need to be in place at the time the property is placed in service so long as it is in place at the time of filing).
- Determination of When Construction of a Project Has Begun. As noted above, the Act provides that grants will be provided only with respect to energy property that is placed in service during 2009 or 2010 or the construction of which began during 2009 or 2010. The Guidance sets forth detailed rules similar to those applicable to bonus depreciation for determining when

construction of a project is considered to have begun for these purposes. The Guidance provides that, in general, construction begins when physical work of a significant nature begins. Preliminary activities, such as planning or designing, securing financing, exploring or researching, are not taken into account. In general, only physical work at the project site is considered. However, off-site physical work may be taken into account where the project is comprised of modular units that are manufactured elsewhere and delivered to the project site for assembly.

Importantly, the Guidance contains a safe harbor that permits an applicant to treat physical work of a significant nature as beginning when the applicant incurs more than five percent of the total cost of the property (excluding the cost of any land and preliminary activities).

- Units of Property. As noted above, it is important for an applicant to know the date on which property is placed in service and, in some cases, the date on which construction of property begins. The Guidance provides that, in determining such dates, all the components of a larger property are a single unit of property if the components are functionally interdependent. For example, in the case of a wind farm consisting of wind turbines that each can be separately operated and metered and can begin producing electricity individually, each such wind turbine (along with its tower and supporting pad) is not functionally interdependent and, thus, is considered a single unit of property. However, an applicant that owns multiple units of property that are located at the same site and that will be operated as a larger unit may elect to treat as a single unit of property all the units eligible for a grant (and any property, such as a computer control system, that serves some or all such units and that is eligible for a grant). For example, in the case of a wind farm described above, an applicant may elect to treat all the wind turbines (along with their towers and supporting pads) and any property that serves some or all of the wind turbines, collectively, as a single unit of property.
- Original Use. The Guidance provides that grants will be made only with respect to property the original use of which commenced with the applicant. Consistent with long-established rules under the investment tax credit, the original use of property will be considered to have commenced with an applicant so long as the cost of any used parts contained within the property does not exceed 20 percent of the total cost of the property.
- Leases and Sale-Leasebacks of Property. The Guidance has incorporated leasing provisions similar to those applicable under the investment tax credit rules. For example, the Guidance provides that a lessor who is eligible to receive a grant with respect to a property may elect to pass through the grant to an eligible lessee of that property. Such an election will cause the lessee to be treated as having acquired the property for an amount equal to the independently assessed fair market value of the property on the date the property is leased to the lessee. For U.S. federal income tax purposes, a lessee to whom a grant is passed through must include ratably in gross income over the recapture period an amount equal to 50 percent of the grant received. The Guidance also provides that such an election is made by a written agreement between the lessor and the lessee that contains information required in the Guidance.

The Guidance also provides that if new property is originally placed in service by a person and, within three months thereof, is sold to an applicant and leased back to the original person, so long as the lessor and the lessee do not elect to pass through the grant (as described above) or otherwise agree to preclude the application of the sale-leaseback rules, the applicant-lessor will be considered the original user of the property and the property will be considered placed in service no earlier than the date of the leaseback.

The Guidance does not provide any details regarding the requirements for a lease to be respected as such under these rules. The most recent leveraged leasing guidelines published by the Internal Revenue Service are set forth in Revenue Procedure 2001-28. Investors should seek advice from their tax advisers regarding the applicability of those guidelines, as well as requirements derived from applicable judicial decisions, to ensure that a lease will be respected for purposes of the grant program.

Recapture of Grant Amounts

The Guidance sets forth rules relating to recapture of grant amounts that are substantially more liberal than those applicable to the investment tax credit. In general, the Guidance provides that, if property with respect to which a grant has been made is sold or otherwise disposed of within the recapture period (*i.e.*, five years) to an entity that would be eligible to receive a grant, no recapture will result so long as such entity agrees to be jointly liable with the applicant for any future recapture. However, grant amounts will be recaptured if, within the recapture period, (i) an interest in the property is disposed of to an entity that would not be eligible to receive a grant (a disqualified entity), (ii) an interest in the applicant is disposed of to a disqualified entity, or (iii) an interest in any pass-thru entity that directly or indirectly (other than through a taxable C corporation) owns an interest in the applicant is disposed of to a disqualified entity. This is a major departure from the investment tax credit rules.

Also, grant amounts will be recaptured if, within the recapture period, the property ceases to qualify as eligible property. For these purposes, property will not cease to qualify as eligible property if the property's production of energy temporarily ceases and, at that time, the owner intends to resume production. Permanent cessation of energy production, however, will result in recapture unless the permanent cessation is due to a natural disaster and the property is not replaced with property with respect to which a grant is allowed.

Applicants are not required to post a bond as a condition of receiving a grant, and such receipt does not create a lien on the property in favor of the United States. Rather, if the government determines that a grant is subject to recapture, the amount due will be considered a debt owed to the United States, which debt could be enforced by the Department of Justice, if necessary. Further, the Guidance indicates that recapture amounts may be collected from (i) the applicant, (ii) an entity that has purchased an interest in the property and has agreed to be jointly liable with the applicant for recapture (as discussed above), or (iii) the lessee of the property, if an election has been made to pass through the grant to such lessee (as discussed above). Accordingly, although the recapture rules applicable to grants are more liberal than those applicable to the investment tax credit, such persons should consider obtaining adequate contractual indemnities and restrictions on transfers, as necessary, in order to protect against the risk of recapture.

Grant Payments Are Assignable

In addition to the information discussed above, the Guidance provides that applicants may assign grant payments to a third party, provided certain requirements are met. Thus, for example, grant payments may be assigned to lenders.

Grant Payments Do Not Subject Property to Certain Requirements

The Guidance also notes that a grant made with respect to property does not cause the property to be subject to the requirements of the National Environmental Protection Act or similar laws, or to be subject to the requirements of the Davis-Bacon Act.