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Treasury releases additional guidance on “Beginning of Construction” issues for Section 1603 Grant Program

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The US Treasury Department released twenty-five questions and answers related to the “beginning of construction” requirement for applicants seeking to receive the thirty percent grant in lieu of tax credit under the Section 1603 program. The guidance, released June 25, 2010, provides additional clarity regarding how Treasury will view certain activities by applicants as they seek to meet the “beginning of construction” requirement by December 31, 2010.

As this deadline is fast-approaching, potential applicants for the 1603 grant have become very focused on understanding the “beginning of construction” requirements for those projects that will not be placed in service by the end of 2010.

The most significant item in the new guidance pertains to accrual method taxpayers who seek to utilize the five percent Safe Harbor test, described in more detail below. For these applicants, a mere prepayment or refundable deposit generally will not count toward meeting the five percent threshold.

Background

Section 1603 of the 2009 American Recovery and Reinvestment Act provided that taxpayers could apply for a thirty percent grant in lieu of the underlying tax credits available for certain renewable energy property. To obtain the grant, the property must be placed in service by December 31, 2010, or if the taxpayer can demonstrate that construction has begun by December 31, 2010, then the property may be subsequently placed in service later (specific deadlines exist for each type of energy project).

The initial guidance on the 1603 program, released by Treasury in July 2009, provided two means by which applicants could satisfy the “beginning of construction” requirement if these are accomplished by December 31, 2010: first, applicant can begin “physical work of a substantial nature;” second, applicant can meet a Safe Harbor test that would include paying or incurring at least five percent of the total cost of the property.

The newly-released guidance provides several points of clarification that will assist applicants in best structuring their activities to meet the end of 2010 deadline. In some instances, the guidance confirms common understandings within the renewable energy community. However, there are some new wrinkles that applicants need to pay close attention to as they seek to obtain the 1603 grant.

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Physical work of a significant nature

- > Physical work on a specified energy property can be met even where the work relates only to a small part of the facility.
- > Treasury intends to closely scrutinize any construction activity that does not involve a “continuous program of construction.” Thus, long delays that are within the applicant’s control can potentially jeopardize an application.
- > Beginning construction of certain roads that are integral to the qualified facility can constitute physical work of a significant nature.
- > Preliminary work such as clearing land, obtaining permits and installing fencing are not sufficient.
- > A binding contract for construction of specified energy property is defined as a contract enforceable under state law, and it cannot limit damages to less than five percent of the total contract price.
- > In the instance of a contract for construction of specified energy property, such as the manufacture of solar panels, the person manufacturing the specified property MUST be able to reasonably allocate specific property to the applicant. Property normally held in inventory therefore would not be considered in satisfying the test.
- > Interestingly, the guidance provides that assuming that an applicant can show that physical work of a significant nature has begun and that work on the project is continuous, the test is met even if a specific site for the project has not been identified.

Five percent Safe Harbor test

- > The guidance provides a fairly strict rule regarding accrual taxpayers and the five percent safe harbor. For accrual taxpayers, the amount and fact of the liability must be fixed, and the economic performance test must be met. As a general matter, the property at issue would need to be provided to the applicant in order to meet this test.
- > As an alternative to the property being provided to the applicant, the applicant may consider when costs are paid or incurred by the manufacturer of the specified property. If the manufacturer is an accrual-method taxpayer, only those costs incurred by the manufacturer in 2010 will be counted toward the five percent Safe Harbor.
- > In cases where title to the property has passed to the applicant but the property is in storage at the manufacturer’s site, property that is delivered to the applicant within 3 ½ months of the date of payment will be deemed delivered to the taxpayer on the date payment is made.
- > The five percent of costs paid or incurred before December 31, 2010 is strictly enforced. Thus, applicants should consider that actual final costs could make the initial five percent paid or incurred insufficient to meet a final cost five percent floor.
- > The guidance also clarifies that if the applicant is applying for multiple properties, and at the time of the final application it becomes apparent that the five percent minimum is not met, applicant could apply for only a portion of the properties (7 wind turbines as opposed to 10 in the project for example) and thus meet the five percent floor. Obviously this would result in the loss of part of the potential grant, but would preserve at least some grant payment.
- > Interestingly, the guidance provides that meeting the five percent Safe Harbor in 2010 would relieve the applicant of any requirement to continue work on the property during 2011, for example, if the property will not be placed into service until 2012.
- > *Finally, as noted above, for accrual method taxpayers, a mere prepayment or refundable deposit generally will not count toward meeting the five percent threshold.*

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Application process

The guidance also provides some additional clarity on the application process where the applicant seeks to rely on the beginning of construction provisions.

- > All applications must be submitted by the statutory deadline of October 1, 2011.
- > For property that has been or will be placed in service in 2009 or 2010, an application demonstrating that construction has begun is not required.
- > For property that is placed in service after December 31, 2010, but before October 1, 2011, applicants need only submit a single application demonstrating both that construction began on the property in 2009 or 2010 and that the property has been placed in service.
- > For property that is placed in service on or after October 1, 2011, applicants must submit a preliminary application by October 1, 2011, demonstrating that construction on the property began in 2009 or 2010. Such applications must then be supplemented at the time the property is placed in service.
- > For property relying on the five percent Safe Harbor and having a cost basis of \$1 million or more, an independent accountant's certification of the costs paid or incurred must be supplied with the application.

The guidance also provides that for applicants submitting an application to document beginning of construction, Treasury will respond to that application informing applicant whether in Treasury's view physical work of a significant nature has commenced, or if the applicant is relying on the safe harbor test, whether qualifying costs have been paid or incurred. Note that this does NOT guarantee eventual receipt of the grant, which Treasury notes must be based on all facts and circumstances at the time the property is placed into service.

Finally, the guidance includes a checklist for applicants that list the items required to file a final application for the grant.

For more information on the 1603 Grant Program, email us at renew@bakertilly.com, or contact a Renewable Energy & Sustainable Solutions specialist:

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