

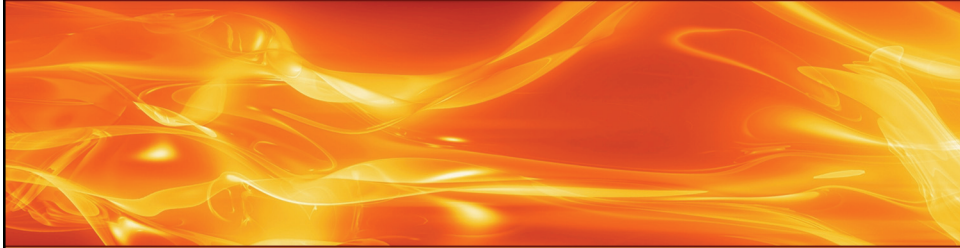
ENERGY BRIEFING SERIES

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ENERGY BRIEFING SERIES



Section 1603 Cash Grants

Guidance for Qualifying Your Project
by December 31, 2010

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Overview

1. Section 1603 Cash Grant Background
2. “Begin Construction” Requirement
3. Eligible Costs
4. Best Practices and Q&A

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Cash Grant Background

- February 2009 – Section 1603 of the American Recovery and Reinvestment Act (ARRA)
- July 2009 – Original Guidance
- March 2010 – Revised Guidance
- June 2010 – Frequently Asked Questions
- December 31, 2010 – Cash Grant set to expire

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Background (cont.)

- Authorized cash grant payments in lieu of tax credits for specified energy property
- Eligible Persons
- Specified Energy Property
- Place in service by credit termination date

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Background (cont.)

When is a facility placed in service?

- “Ready and available for its intended use” – IRC definition
- Public utility signoff – PTO letter
 - PTO: Permission to Operate
- Facility completed, licenses obtained, pre-operational testing complete

Commercial Operation Date

- When customer is contractually obligated to buy power

Placed-In-Service dates can differ

- Solar ITC and depreciation of solar assets – IRC Sections 48 and 168
- Depreciation of other assets – IRC Section 168

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Background (cont.)

- Property placed in service in 2009 or 2010
 - Applications must be submitted by October 1, 2011
 - Paid within 60 days of application

- Property not placed in service in 2009 or 2010
 - Must “begin construction” by December 31, 2010
 - Must submit an application by October 1, 2011
 - If the property is placed in service at the time of application – paid within 60 days
 - If the property is not placed in service at the time of application – paid within 60 days after final supplemental information submitted after it is placed in service

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Background (cont.)

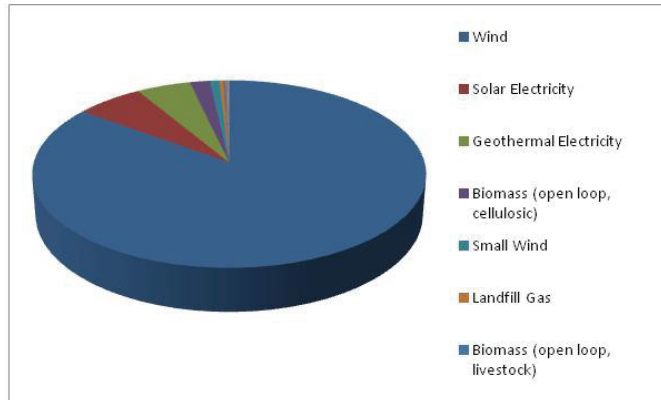
Specified Energy Property	Credit Termination Date	Applicable Percentage of Eligible Cost Basis
Large Wind	Jan 1, 2013	30%
Closed-Loop Biomass Facility	Jan 1, 2014	30%
Open-loop Biomass Facility	Jan 1, 2014	30%
Geothermal under IRC sec. 45	Jan 1, 2014	30%
Landfill Gas Facility	Jan 1, 2014	30%
Trash Facility	Jan 1, 2014	30%
Qualified Hydropower Facility	Jan 1, 2014	30%
Marine & Hydrokinetic	Jan 1, 2014	30%
Solar	Jan 1, 2017	30%
Geothermal under IRC sec. 48	Jan 1, 2017	10%*
Fuel Cells	Jan 1, 2017	30%**
Microturbines	Jan 1, 2017	10%***
Combined Heat & Power	Jan 1, 2017	10%
Small Wind	Jan 1, 2017	30%
Geothermal Heat Pumps	Jan 1, 2017	10%

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Background (cont.)

Which technologies are getting the money?



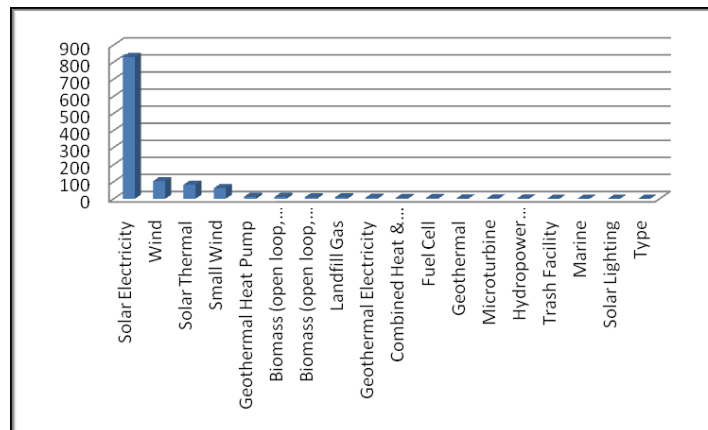
Source: "Solar Commercial Financial Intensive" workshop at Solar Power International on October 11, 2010

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Background (cont.)

Who is submitting the most applications?



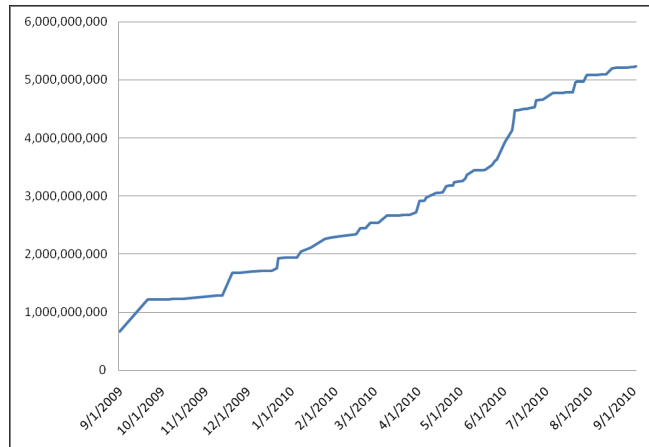
Source: "Solar Commercial Financial Intensive" workshop at Solar Power International on October 11, 2010

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Background (cont.)

Total Disbursements



Source: "Solar Commercial Financial Intensive" workshop at Solar Power International on October 11, 2010

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Background (cont.)

Treasury Grant Program Report Card

- 21 months later
- \$5.2 billion disbursed to date
- 1,303 projects
- 17 different technologies

A success!

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“Begin Construction”

Two ways:

- Begin “physical work of a significant nature”
or
- Meet 5% safe harbor test

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“Begin Construction” (cont.)

Physical work of a significant nature:

- May occur on-site or off-site
- Must be “continuous”
- Threshold may be less than 5% safe harbor
- Property must be newly constructed and not inventory

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“Begin Construction” – Examples

Examples of Work that Qualifies	Examples of Work that Does Not Qualify
Physical work on a transformer that increases the voltage of electricity produced at the facility to the voltage needed for transmission	Physical work on a transmission tower located at the site
Laying the foundation for one wind turbine that is part of a larger wind farm	Preliminary work such as clearing land, obtaining permits or putting up fencing
Starting construction on onsite roads that are used for moving materials to be processed (e.g., biomass) and roads for equipment to operate and maintain the qualified facility	Construction of roads for access to the site, or roads used solely for employee or visitor vehicles
Construction of a structure that is essentially an item of machinery or equipment or a structure that houses property used as an integral part of a qualified activity if the use of the structure is so closely related to the use of the housed property that the structure clearly can be expected to be replaced when the property it initially houses is replaced	Dismantling and removing an existing facility in order to construct a new qualifying facility
The manufacture of solar panels under a binding written contract after such contract is entered into by the applicant and the manufacturer	Test drilling of a geothermal deposit

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“Begin Construction” (cont.)

Binding Contract Requirements:

- Enforceable under state law
- The contract cannot limit damages to less than 5% of price
- Only work entered into after the contract is executed
- Contracts cannot provide a full refund

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“Begin Construction” (cont.)

Advantages of the Physical Work Test:

This threshold may be lower than the 5% safe harbor, particularly where a project has high expected capital costs.

Example: A wind facility can meet the test by one of the following:

- Excavation for the foundation
- Setting of anchor bolts into the ground
- Pouring of concrete pads of the foundation

Note: Developers and banks are hesitant to rely on the physical work test alone

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“Begin Construction” (cont.)

5% Safe Harbor Test:

Met when more than 5% of the total, **actual** costs of the specified energy property has been paid or incurred by December 31, 2010

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“Begin Construction” (cont.)

When are costs paid or incurred?

Cash-method taxpayers: Costs are taken into account when paid by the taxpayer

Accrual-method taxpayers: Costs are taken into account when “incurred”— the “all-events test” of Treas. Reg. §1.461-1(a)(2) applies, which includes an economic performance test

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“Begin Construction” (cont.)

When are costs incurred?

Economic Performance

The cost of such property is treated as “incurred” or provided either when:

- title passes, or
- delivered

Note:

- 3 ½ month rule
- Look through to supplier’s costs

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“Begin Construction” (cont.)

Advantages of the 5% Safe Harbor

- Allows for master contract allocations
- No “continuous” requirement
- Includes costs that would not qualify for the physical work test

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“Begin Construction” (cont.)

Property Constructed for the Taxpayer by Another Person – Back-end Grant Example

Preliminary activities (2009 – 2010)		\$ 2,000,000
Physical work by other parties:		
	2010	7,000,000
	2011	<u>191,000,000</u>
	Total cost	\$200,000,000

- Developer paid a \$75,000,000 turbine deposit in 2010
- Plant was provided to the developer in 2011.
- When are the costs incurred?
- How is the 5% safe harbor applied?
- Is the asset eligible for a Section 1603 Treasury grant?
- If so, how much qualifies for a grant?

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Eligible Costs

Eligible Property Defined

- Equipment that uses renewable energy to generate electricity
 - Constructed by the taxpayer
 - Acquired by taxpayer and first used by taxpayer
 - Exception for sale-leaseback transactions
 - 90 day rule (Old IRC Section 48(b)(2))

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Eligible Costs (cont.)

What costs are eligible for the credit?

- Equipment (solar panels, wind turbines, but not transmission)
- Hard construction costs in general
- Direct and indirect costs of installation
 - System integration / design / testing / developer fee
 - Permits, fees etc.
 - Interest expense prior to PIS – subject to Section 266 election
 - Other soft costs

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Eligible Costs (cont.)

- Practical Issue: extent to which a support system qualifies for the credit
- Roof repairs?
- Base for ground-mounted units?
- Parking garage structures which support panels but provide shade?
 - Reasonable allocation
 - What is required to support specific energy property?

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Eligible Costs (cont.)

What costs are not eligible

- Permanent loan fees, syndication costs, etc.
- Organization costs
- Costs allocated to the building
 - Roof repairs generally
 - Parking garage / carport installations – cost allocation question
- Transmission lines to grid generally not eligible
- Costs funded by some public utility subsidies
- Section 136 applies – basis must be reduced

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Eligible Costs (cont.)

Documentation

General: With their application, applicants must submit payment documentation to support the cost basis claimed for the property. For properties that have a cost basis in excess of \$500,000 applicants must submit an independent accountant's certification attesting to the accuracy of all costs claimed as part of the basis of the property.

Physical work: If under a binding written contract, applicant must submit (1) a copy of the contract, and (2) a statement from the contractor, signed under penalty of perjury, describing the work commenced and that it commenced pursuant to the contract.

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Best Practices

General

- Make sure that all agreements meet the requirements for "binding written contracts."
- Agreements should address the question of allocation of risks if the various requirements of Section 1603 are not met.
- If possible, attempt to meet both tests, as this may be particularly important to financing parties.
- Applicants should make sure that they have the narrative in their application reviewed by a professional.
- Do not rely on soft costs (e.g., developer's fee) to meet the test.

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Best Practices

Physical Work:

- EPC and supply contract provisions
 - Require work to start this year
 - Maintain consistent and customary timeline
 - Address title
 - Require certifications for work started

- Ensure property is new

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Best Practices

5% Safe Harbor:

- Inform contractors/suppliers of safe harbor

- Cash payments alone are not sufficient

- Be conservative in financial modeling

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Questions and Answers

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