

Section 1603 Payment Update

by Keith Martin and John Marciano, in Washington

The US Treasury Department posted a series of questions and answers to its website in late June to help project developers understand what they must do by year end to be considered to have started construction of wind, solar and other renewable energy projects.

Projects must be under construction by December to qualify for cash grants from the US Treasury for 30% of the project cost. The grants are part of an economic stimulus program that the Obama administration put through Congress in February 2009. The grants only apply to projects that are completed in 2009 or 2010 or that start construction in 2009 or 2010.

There are two ways to prove a project is under construction.

Many developers had been focusing on showing they started “physical work of a significant nature” during 2010.

However, the latest guidance may shift attention back to trying to prove that the developer incurred more than 5% of the project cost by year end, the other way of proving that construction started this year.

Continuous Construction

The reason is the Treasury said that construction must be continuous once a developer claims he started construction by commencing physical work. There is no requirement for continuous construction under the 5% test.

Before the latest guidance, many developers had soured on the 5% test after a disappointing meeting between wind turbine manufacturers and the Treasury on April 6 that suggested the 5% test would be tough to meet.

The Treasury said:

[it] will closely scrutinize construction activity that does not involve a continuous program of construction or a contractual obligation to undertake and complete within a reasonable time, a continuous program of construction. Disruptions in the work schedule that are beyond the applicant’s control (for example, unusual weather or a site at which work can only be performed during certain seasons)

will be taken into account in determining whether or not an applicant has undertaken a continuous program of construction.

Lenders who have been making equity bridge loans against future Treasury cash grants will have to evaluate the additional risk that a grant will not be paid on grounds that construction was not continuous. A senior Treasury source said the intention was not to audit construction progress, but avoid criticism from Congress that a developer “could put down a slab” and then do nothing for another year.

Chadbourne had expressed the view to Treasury that it is important for a developer to be able to meet any such requirement for continuous construction based on its reasonable expectation in 2010. The Treasury addressed this by suggesting it will look for “a continuous program of construction or a contractual obligation to undertake and complete within a reasonable time” (emphasis added). Ellen Neubauer, the cash grant program manager, confirmed that was the intention. If physical work begins under a contract, she said, it will meet the continuous construction requirement if the contract requires that the work be completed within a reasonable time and any disruptions or delays are beyond the control of the developer.

Other Developments

In other developments, the Treasury released a checklist in mid-June for developers to use when applying for cash grants. The Treasury is required by statute to pay grants within 60 days of receiving an application. It had been paying grants in as little as two to three weeks early in the year. However, by spring, grants were taking longer than 60 days. The checklist is supposed to help applicants avoid followup questions that delay payment.

The National Renewable Energy Laboratory (NREL), which reviews the grant applications for the Treasury, has been asking more questions recently about the tax bases claimed by grant applicants. The grants are 30% / *continued page 2*

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of the “tax basis” that the owner has in the equipment at a project.

NREL is not simply accepting the tax bases claimed and has been asking questions in at least two situations.

One is where owners of solar photovoltaic equipment claim a higher cost or value for solar panels than the panels can be purchased from competitors. The other is where the amounts claimed as basis in any renewable energy project seem high in relation to the bases being claimed by other grant applicants. In the latter situation, NREL has probed to see whether the reason for the higher basis is impermissible mark ups on intercompany payments. For example, US tax regulations bar mark ups on equipment or services supplied by one corporation to another corporation in the same consolidated tax group.

At least one solar company filed suit against the government in federal court charging that the Treasury refused illegally to pay it \$2.33 million in cash grants after the company applied for the grants in August 2009. The company, Pure Power Development, mounts solar panels on flat-bed trucks. Neither the complaint by the company nor the government’s response filed in late May sheds light on why the company ran into problems.

An effort to extend the cash grant program by giving developers until 2012 to start construction came up short in the US Senate in June after a bill extending unemployment benefits to the long-term unemployed and a variety of expired tax benefits fell victim to a Republican filibuster.

Senator Maria Cantwell (D.-Washington) had planned to try to amend the bill during Senate debate. The renewable energy trade associations are eyeing an energy bill that the Senate may take up as early as July as another possible vehicle for an extension.

Most lobbyists give an extension a little better than a 50-50 chance. The tax-writing committee in the House favors an extension, but would convert the program into a tax refund program in order to avoid having to ask the spending committees for more money. The government would pretend that developers overpaid their taxes by 30% of the project cost. Developers could then apply for the money back. This would work like the current cash grant program, except that the tax refunds would not be paid until the year after a project is completed.

The outlook in the Senate is less clear. The Cantwell amendment would have left the existing program intact by

merely changing dates. Some members of Congress like the stimulative effect of having a year-end deadline, even if the program is extended later.

None of the extension proposals would extend the existing deadlines to complete projects — only to start construction. The current deadlines to complete are 2012 for wind farms, 2013 for geothermal, biomass, landfill gas, incremental hydroelectric and ocean energy projects, and 2016 for solar and fuel cell projects.

One of several possible complications for the extension effort is the staff of the Joint Committee on Taxation is reassessing what the program costs the government. It estimated in 2009 when the original program was enacted that the grants would cost the government only \$5 million, on the theory that they merely substitute for tax credits that would have been claimed otherwise. The committee staff is debating whether the program has caused more construction of renewable energy projects in the United States than would have occurred without the program.

Proof of Construction

Developers planning to claim grants on projects that were merely under construction by year end will have to submit proof. The Treasury said in late June that it will want statements from contractors and independent engineers “under penalties of perjury” to confirm that construction started.

Developers should be sure to write into contracts with vendors that they will require such statements.

The Treasury said any developer relying on the physical work test for a project that will receive a cash grant of at least \$300,000 must submit a report from “an independent engineer, signed under penalties of perjury, describing the project’s eligibility; including a detailed construction schedule; estimated budget for the project and a description of the work that has commenced including any invoices for the work performed.”

If the physical work is done by a contractor — for example, a wind turbine or solar module supplier — the grant application must also include a copy of the contract and a “statement from the contractor, signed under penalties of perjury, describing the work that has commenced and certifying that the work commenced pursuant to the binding written contract.”

A developer relying on the 5% test for a project that will receive a grant of at least \$300,000 must submit a statement from an independent

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accountant confirming the method of accounting used (*e.g.*, accrual) and stating “the amount that has been incurred before the end of 2010; a detailed description of the costs incurred; and an estimate of” expected eligible tax basis. The statement must also attach invoices or other financial records to prove the dollar amounts claimed.

In addition, if some of the spending was by a contractor, the grant application must include a statement from the contractor, signed under penalties of perjury, attesting to the costs incurred on the project in 2010.

Physical Work

The Treasury said it is enough to start work in 2010 on even one wind turbine for a project as long as the turbine was ordered under a binding contract and the continuous construction requirement is met.

Work on roads on the site counts as the start of physical work. However, the roads must be roads used to move fuel — for example, at a biomass project — or spare parts needed during the operating phase. Roads do not count if they merely provide access during construction or will be used solely by employees to get to and from work.

Dismantling an existing facility to start work on a new one does not count.

Putting up a tortoise fence at a solar project does not count.

A developer can count the start of physical assembly of turbines or solar modules at a factory even though the project site has not been identified yet. The site does not have to be identified even by October 1, 2011, which is the deadline for all remaining grant applications to be submitted for projects that are still under construction. The site, once designated, can change without losing the right to a grant.

5% Test

The Treasury confirmed that costs do not count as “incurred” in 2010 until there is delivery of equipment or services or at least passage of title from the contractor to the developer. It is generally not enough merely to have paid for equipment.

The Treasury said equipment — for example, a wind turbine — may be considered to have been delivered even though it remains in storage at the manufacturer’s factory. One of the answers posted to the Treasury website in June

said, “Property is provided to the applicant either when title to the property passes to the applicant or when it is delivered to or accepted by the applicant, depending on the applicant’s method of accounting.” A senior Treasury source said the phrase “depending on the applicant’s method of accounting” means the developer must be consistent. If it has been treating costs as incurred for tax purposes on its past tax returns when title passes, then it must look to title. If it has focused in the past on delivery, then it must continue to do so. The source said a developer cannot choose passage of title or delivery, whichever occurs first.

The Treasury confirmed that it is applying a 3 1/2 month rule. Costs are not incurred until title passage or delivery, with one exception. They are incurred when payment is made if delivery or title passage is expected within 3 1/2 months of payment. Some wind companies had asked that the 3 1/2 months be measured from December 31, 2010, so that payments any time during 2010 would count if delivery occurs by April 15, 2011. The Treasury said no.

A turbine vendor or other equipment supplier cannot count the cost of components that it pulls out of inventory. The grant is supposed to stimulate new manufacturing.

The developer can rely on a statement by the equipment supplier about the costs it incurred. The supplier must sign the statement under penalties of perjury.

Other Issues Addressed

Large wind companies sign frame agreements under which they order turbines for multiple projects. Later, when turbines are designated for use in a particular project, a “daughter” contract is signed between the turbine supplier and the project company basically copying out terms from the frame agreement.

The Treasury said that any grandfather rights established in a project under the frame agreement will carry over to the project company.

A developer can apply for a grant after the developer believes it started construction without waiting for the project to be placed in service. The Treasury said it will respond whether it agrees that construction started, although the assurance may not stand up if new facts come to light that were not disclosed by the developer. ©

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