

# Treasury Clarifies Cash-Grant Rules For Developers

*The U.S. Department of the Treasury has further defined project language for developers before the deadline.*

BY JOHN MARCIANO AND JOHN MODZELEWSKI

Wind developers are focused on what they must do by year's end to qualify for a 30% cash grant from the U.S. Department of the Treasury. Wind farms that go into service this year are eligible for the grant. Wind farms that did not go into service by the end of this year must have started construction in 2009 or 2010 and must be placed into service by the end of 2012.

The grant is 30% of the cost of the share of the project that is necessary to generate electricity and that is integral to the operation of the facility. That is 95% to 97% of the cost of a typical land-based wind farm. Grants are not paid on transmission equipment.

What does it mean to be placed in service? Each turbine, pad and tower is a separate facility for purposes of the grant and can be placed into service separately. However, the Treasury guidance for the grant program notes that if turbines are on the same site and operated as a larger unit, the owner can elect to treat each turbine and the control system as one larger facility. If the owner does so, then the entire project would be considered placed into service on the date the last turbine goes into service.

The Treasury guidance states that "placed into service" means that the property is ready and available for its specific use. The legislative history says that the grant program is intended to

mimic the investment tax credit (ITC). The Internal Revenue Service (IRS) and the courts treat a power plant as in service for investment-credit purposes when five things have occurred:

- Physical construction has been completed, although contractor personnel can still be at the site in support of startup and maintenance and the completion of minor tasks, such as painting and attending to the punch list;

- The taxpayer has taken legal title and control of the facility;

- The taxpayer has the licenses and permits needed to operate the facility;

- Pre-operational tests have demonstrated that the facility can serve its intended function. Other testing can occur after the facility is in service to determine whether the facility can operate at the design capacity and to identify and eliminate defects; and

- The facility must be synchronized to the utility grid so that it is able to deliver its electricity to market.

The IRS takes the position that the facility must also be in "daily operation" and has ruled privately on several occasions that power plants are not in service until they are. However, so-called provisions for daily operation are not defined in these rules. A power plant is considered in daily operation when it is routinely operating to supply power to the transmission grid for sale to customers.

The ability to operate at full capacity is not a prerequisite to be considered in service. The IRS treats power plants as in service when they are still ramping up after initial start up and testing. For example, a nuclear electric-generating unit is considered in service when its initial synchronization and power operation is achieved at greater than 17% of the electrical capacity of the unit and continues to ramp up steadily from there. Additionally, a solid waste disposal facility that produces saleable steam is considered in service despite operational problems that made it unable to operate at its rated capacity.

Serious mechanical problems that occur later may suggest that a facility was not in service when originally thought. An example is when a power plant is shut down soon after start up in order to essentially be rebuilt because of latent defects.

The bar is higher for a taxpayer entering a new business than for a taxpayer already in that business. For example, in the case of a wind developer going into a solar business, the courts have held that the developer must actually have put the equipment to use. It is not enough merely to show it was capable of operating.

## **Under construction**

There are two ways to show that construction started. Either "physical

work of a significant nature” must start or more than 5% of the total project cost must be incurred by year’s end.

Physical work of a significant nature has started if any of the following work is underway: excavation of the foundation, setting of anchor bolts into the ground or pouring of concrete pads of the foundation at the site.

It is enough to show that work has begun. If the owner elects to treat all turbines on a site as one facility, then starting work on one turbine pad at a wind farm would be sufficient, provided that work progresses continuously thereafter or there is a contractual obligation to complete the rest of the project within a reasonable time.

If work starts on excavation or laying foundations but subsequently stops for an extended period, then the Treasury may determine that the project was not yet under construction unless the contractor has an obligation to move the construction forward.

General site clearance and contouring are not considered the start of construction. Work on roads and paved parking areas counts as physical work, but only if the roads and paved parking areas will be used to deliver spare parts after the project is in operation. Roads and parking used solely for employee and visitor traffic or for construction do not qualify.

Preliminary work – such as geotechnical, design and engineering, or securing financing – does not count as physical work. The start of physical assembly of major components off site at a factory counts as physical work. However, the work must be done under a binding written contract that is entered into before the manufacturing of the equipment begins.

To count off-site work under a turbine-supply agreement as the start of physical work, the agreement must be a binding contract for tax purposes. To be “binding,” the contract must include more than an option to choose equipment later. The Treasury guidelines say that “the amount and design specifications of the property to be purchased” must be clear in the con-

tract. In the event that the developer walks away from the project, the contract should not limit damages to less than 5% of the contract price. Any conditions to performance by a party must be outside the control of the parties.

There is a risk that amending the contract after this year could lead to the loss of grandfather rights. Minor modifications in design are not a problem. The later addition of a cold-weather package for wind turbines is an example of a minor modification. If the Treasury were to follow the same rules it used after the ITC expired in 1986, an amendment that increases the contract cost by more than 10% would be considered substantial.

Another way to show that construction has started is to incur more than 5% of the total cost of the share of the project that is eligible for the grant by Dec. 31. Do not include any spending on ineligible equipment, such as interconnection and transmission assets, in either the nominator or the denominator of the calculation.

Electing to treat an entire wind farm as a single unit of property can be advantageous if it will be possible to incur 5% of the total project cost by Dec. 31. The entire wind farm will be considered under construction by Dec. 31, even though work on only part of the project is underway.

The project must be completed by December 2012 to be eligible for a grant. If not all the turbines can get into service by that date, the owner may still qualify for a partial grant. However, an owner should be careful not to elect to treat the entire project as a single project for purposes of starting construction. The Treasury has said in guidance that if, for example, only 40 turbines are placed in service by December 2012 at a 50 turbine wind farm that is treated as a single unit of property, an applicant would be eligible to receive a grant based on the 40 turbines that were placed in service.

### **Spending**

An amount cannot be counted as incurred until property or services are

provided to the purchaser. At minimum, a title to property transfers should be provided. For these purposes, developers can assume property has been provided to them when the title transfers only if this is done for tax purposes. Otherwise, developers must wait until the property is delivered to treat it as provided.

It is not enough to have paid for equipment or services; however, there is one exception. Developers can treat an amount as incurred in 2010 if they reasonably expect to receive the property or services within 3 1/2 months of payment.

The developers’ direct spending on things such as legal and consultancy fees to arrange construction permits, geotechnical work and preliminary engineering design work qualifies to the extent that the spending relates to eligible equipment.

Spending by contractors under a binding written contract can be included in the calculation as well. If a contract is not a binding written contract, then only spending by the developers is included in the 5% calculation.

Contractors should not count spending on existing inventory on the contractors’ accrued costs. Thus, for example, if contractors have components on hand when entering into a binding contract to supply turbines, they cannot count the costs of those components. Spending has to be on new equipment.

No cost should be counted twice. For instance, if a cost is incurred when a contractor under a binding written contract makes the expenditure, it may not be counted again when the taxpayer receives the property. **SY**

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