



Alternative & Renewable Energy Tax Newsalert

IRS Issues Q&A Guidance on Section 1603 Treasury Grants

March 12, 2012

On March 9, 2012, the Internal Revenue Service released Notice 2012-23 containing guidance on tax issues related to the receipt of grants in lieu of tax credits for specified energy property under Section 1603 of the American Recovery and Reinvestment Act. The notice makes clear that receipt of a Treasury grant is only the beginning of an applicant's tax compliance process and emphasizes that the IRS will not view itself as bound by informal guidance Treasury gives applicants with respect to tax accounting issues.

The notice states that both the IRS and Treasury had received numerous questions on tax-related issues arising under Section 1603. However, it cautions that "[a]ny guidance, documents, interpretations, or approvals issued by Treasury relating to the Section 1603 program are not precedent for the federal income tax treatment of specified energy property under sections 45 and 48 of the Internal Revenue Code." The guidance addresses selected issues in a question and answer format.

Highlights of the IRS notice

The first Q&A addresses the income and basis effects of receipt of a Section 1603 grant. The IRS confirmed that grant payments are excluded from gross income and specified energy property basis is reduced by 50 percent of the grant payment relating to such property. The IRS also stated that project cost eligibility is determined

with regard to the costs properly capitalized for purposes of depreciation.

The second Q&A covers the federal income tax treatment of grant applicants who have also received Department of Energy loan guarantees or public utility subsidies. Here, the notice refers to Treasury FAQ # 41, which provides that federal or state incentives that are not includable in income of grant applicants may require a basis reduction. For the two specific incentives highlighted by the IRS, it determined that neither were includable in income. However, while DOE loan guarantees do not require a basis reduction, public utility subsidies do require a reduction in basis equivalent to the amount of the subsidy excluded from income, pursuant to IRC section 136.

The third Q&A applies specifically to partnerships eligible for Section 1603 that have as a partner a corporation that is a tax-exempt controlled entity. In such cases, the IRS will apply IRC section 168(h)(6) to determine the appropriate depreciation recovery period for property allocable to that partner. If the tax-exempt controlled entity and the partnership allocations to that entity meet certain conditions, that will result in the application of the longer recovery periods of the Alternative Depreciation System to property allocated to the entity.

The fourth Q&A provides that, in situations in which a Section 1603 applicant chooses to group



multiple independent units of property into a single unit of property for grant purposes, as permitted by Treasury, such treatment will not alter the standard treatment of the individual units for purposes of depreciation deductions.

Finally, the fifth Q&A clarifies that, in sale leaseback transactions that occur more than three months after the property is placed into service, the seller/lessee is not subject to the income inclusion rules normally imposed on lessees where the section 1603 payment is passed through by the lessor. Instead, in such situations, the seller/lessee is treated as a direct owner of grant eligible property would be and reduces its basis in the property when determining its gain or loss on the sale.

PwC observations

The most significant aspect of this notice is the clear distinction between Treasury guidance for purposes of grant administration and the IRS's interpretation of tax accounting issues. In a previous Chief Counsel Advice memorandum, the IRS stated that it would audit grant recipients to review eligible costs, thus reserving the right to make determinations regarding the Section 1603 program independent of Treasury. This notice is consistent with that approach and emphasizes that informal guidance from Treasury on federal income tax issues during the grant application process may not bind the IRS.

The five Q&As are consistent with the IRS's interpretation of the relevant Code provisions and may differ from Treasury's approach to administering the grant program. The chief

example of this comes from Q&A #4 where the IRS will adhere to unit of property-specific placed in service dates despite the placed in service date used for purposes of applying for a section 1603 grant.

The notice highlights that, even after grant applicants receive funding from Treasury, they should work to ensure that the federal income tax treatment relating to the grant and the underlying property is consistent with the Internal Revenue Code and relevant IRS positions.

For more information

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For more information about using energy tax incentives to meet your renewable energy goals, please contact a member of PwC's Sustainable Business Solutions tax team:

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