



Alternative & Renewable Energy Tax Newsalert

Treasury issues guidance on calculating eligible basis for solar property under section 1603 renewable energy grants-in-lieu of tax credits

On June 30, Treasury posted guidance how eligible basis determinations are made under the Section 1603 grant-in-lieu of renewable energy tax credits.

The guidance sets forth general tax principles that basis generally is the cost of property plus other appropriate intangible costs. However, the guidance notes that basis may be adjusted by the Treasury where it believes that a taxpayer's proposed basis in a particular piece of property does not reflect true economic cost.

The guidance appears to reflect tax advisers' understanding of the methods Treasury utilizes to evaluate whether an applicant's project costs are within a range of what is seen in the market. The guidance states that Treasury considers "relevant publicly available information and analyses by various experts, data from existing 1603 applications and other confidential sources, and the 1603 review team's experience with solar PV properties.

The guidance notes that applicants may use one of several methods in setting forth their proposed basis in grant eligible property. These include:

- Cost approach--based on actual cost to construct the property which can include property cost, soft costs, and profit. The guidance notes that Treasury generally prefers this method.
- Market approach--based on comparable properties placed in service in the past two years, but the guidance notes that caution should be exercised in choosing appropriate comparables.

- Income approach--based on discounted value of future cash flows from project. The guidance notes that Treasury considers this to the least reliable method of valuation given the numerous factors and subjective nature of income modelling.

PwC Observations

The guidance appears to be at least partially in response to the recent case *ARRA Energy Co I v. United States*, No. 10-84 C (Fed. Cl. Jan. 18, 2011), where Treasury had denied a grant application in which it asserted that the applicant had not submitted sufficient documentation to support its proposed cost basis. The court determined that Treasury had no authority to deny payment for a properly submitted application.

Treasury Discusses Cost Basis

On July 13, the American Bar Association sponsored a webcast in which Ellen Neubauer, the director of the 1603 grant program for Treasury, discussed both the recent guidance and Treasury's general approach to evaluating the cost basis of 1603 projects. Neubauer stated that the methodology, while "admittedly imperfect," nonetheless reflects that overstated cost basis is a greater risk to Treasury than the IRS, as Treasury does not possess the same array of tools to recover overpayments. As a result, Treasury has established benchmarks for project costs using the data sources discussed in the guidance, and according to Neubauer, will seek additional information on projects with costs "significantly" outside those parameters.



In addition to the benchmarking of costs, Neubauer also said that Treasury is concerned about 1603 projects involving related parties because fees paid between related parties, such as development fees or professional fees, as well as complex ownership structures involving related parties are a possible means to inflate the cost basis of 1603 projects. Where there are such transactions between related parties, Treasury will impose heightened review on the 1603 applications.

Since the beginning of the 1603 program in June 2009, Neubauer said applicants have submitted over 20,000 applications submitted and received over \$8 billion in grants. In light of the new guidance and her statements on Treasury's review of cost basis, Neubauer emphasized that denials of applications for cost reasons are rare, as the more frequent action by Treasury is a reduction of the eligible basis used to calculate the grant amount.

PwC Observations

Neubauer's description of Treasury's process for evaluating basis issues is consistent with PwC's experience with the section 1603 program. In practice, when questions on the cost basis of 1603 projects arise, Treasury officials typically will entertain discussion and additional

documentation to substantiate project costs. Grant applicants whose project costs exceed industry averages should anticipate additional scrutiny from the outset and may wish to craft their initial applications carefully to anticipate Treasury's needs for additional documentation of such costs.

For more information

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