



Alternative & Renewable Energy Tax Newsalert

Treasury's 1603 Grant Program: What should you consider before the December 31st deadline?

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Since 2009, many companies have benefitted from the grant-in-lieu of tax credit program provided by section 1603 of the American Recovery and Reinvestment Act (the "1603 grant program"). Under the 1603 grant program, companies may elect to apply for a cash grant from Treasury in lieu of claiming an investment tax credit or production tax credit on many forms of renewable energy property. The grant may reimburse 10% to 30% of eligible costs, depending on the project technology.

To be eligible for the 1603 grant program, companies must "begin construction" on their projects by December 31, 2011. Although this deadline was extended into 2011 by legislation enacted late last year, currently, there appears to be little momentum in Congress for a further extension of the program. All applicants will be required to demonstrate how they met this deadline, and those whose projects will not be placed in service prior to October 1, 2012 will need to file a notice regarding the beginning of construction prior to that date.

Recent guidance from Treasury and the IRS, and experience in working through issues raised by the 1603 grant program, suggests that grant applicants should keep several important issues in mind as they prepare for the year-end deadline.

Meeting both prongs of the "begin construction" safe harbor

Treasury's guidance outlines that the beginning of construction can be demonstrated by either (a) incurring at least 5% of eligible project costs ("5% test") or (b) beginning "significant physical work" in a plan of continuous construction. Treasury has clarified that applicants may satisfy these requirements, if prior to December 31, 2011, the project is commenced under a written binding contract that does not limit damages to less than 5% of the total project price. In such cases, either the physical work performed by the contractor or the costs incurred by the contractor may be used by the applicant to meet the "begin construction" safe harbor, if sufficient documentation can be obtained from the contractor.

While many applicants have focused on the 5% test, in some cases the significant physical work standard may be easier to meet. In some circumstances, it also may be possible to conclude that a program of work is continuous notwithstanding a gap period in site work if that gap is customary for the region (e.g., certain forms of outdoor work that are not performed in the winter).

Since failing to meet one of these tests in a timely manner precludes receiving a 1603 grant, we believe that, where possible, applicants should



strive to achieve and document compliance with both safe harbor tests.

Making sure you have a "project"

Some potential applicants have wondered whether a newly formed project company that merely purchases components to a renewable energy project before year end might be "grandfathered" into eligibility for the 1603 grant program as long as the costs incurred amount to at least 5% of the value of the eventual project. Although Treasury's guidance suggests that applicants can demonstrate continuous physical work even if they do not yet have an identified site (see Q&A 14), there nonetheless must be a "project." We understand that Treasury will look for relevant evidence of an identifiable project, such as engineering and permitting activity or marketing material. In other words, simply purchasing energy equipment, like solar panels, without otherwise demonstrating the intention to carry out a project is unlikely to meet the eligibility criteria for the 1603 grant program. Potential applicants should therefore consider preparing time-dated documents of their engineering plans, drawing, project summaries and the like. Further guidance from Treasury on this point could be helpful to potential applicants in concluding how far down the road they need to be in identifying a project site, acquiring the rights to develop it, and permitting it for installation of the renewable energy property in order to have the ability to apply the begin construction safe harbor to that site.

Being prepared for an IRS audit

In a recent generic legal advice memorandum, AM 2011-004, dated September 27, 2011, the Office of Associate Chief Counsel (Passthroughs & Special Industries) outlined its legal analysis for treating overpayments of 1603 grant awards as taxable income and for allowing taxpayers a deduction if and when such amounts are repaid. As many other commenters have noted, the news here is not that the IRS applies gross income principles in these circumstances -- it is that the IRS now has concluded that it has the authority to audit 1603 grant awards.

Despite initial indications that Treasury and the IRS would rely on the third-party attestation process called for in the 1603 grant guidance, we now understand that the IRS intends to audit grant awards much in the same fashion that it scrutinizes investment tax credits claimed on income tax returns and that it remains concerned that some grant applicants have inflated their grant-eligible basis through excessive developer premiums or in lease-based transactions.

Companies should be aware of this as a potential IRS examination issue and be prepared to justify eligible basis at the project invoice level even when they are purchasing projects from developers prior to the placed-in-service date. It likely will not be sufficient to point to the purchase price for the overall project, even when that has been negotiated in a third-party transaction. And companies should consider benchmarking developer premiums and overall installed costs per kilowatt against other market transactions to get a sense of whether Treasury will view those costs as reasonable. Guidance issued over the summer shows how Treasury intends to apply such metrics for solar projects.



Similar average cost data is published by the Department of Energy for other technologies and may be applied by analogy to other types of 1603 projects.

The bottom line

While the 1603 grant program remains an important and valuable source of support for renewable energy projects, recent guidance and commentary from Treasury and the IRS reflects that a heightened level of review will be applied to 1603 applications. Applicants need to plan ahead to make sure that their projects are well documented and understand how their project costs will be benchmarked against industry averages. They also should be prepared to explain how their project meets the intent of the 1603 grant program as well as the technical requirements outlined in the grant guidance.

Treasury's guidance in this area has been less formal than for many traditional tax issues, and it may evolve even further before year-end. Applicants will want to keep a close eye on these developments and ask their advisors for further

information and details about the grant application and administration process.

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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