

United States: US Treasury Revises Cash Grant Program Guidance

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On March 15, 2010, the US Department of the Treasury (Treasury) released revised guidance regarding when construction is deemed to have begun for purposes of the cash grant program for renewable energy projects.

Background. The cash grant program was enacted by Section 1603 of the American Recovery and Reinvestment Act of 2009. The program allows an eligible person to apply to Treasury for a grant with respect to certain renewable energy property in lieu of claiming the production tax credit under Internal Revenue Code Section 45 or the investment tax credit under Internal Revenue Code Section 48. In order for renewable energy property to qualify for a grant under Section 1603, either it must be placed in service in 2009 or 2010 or construction must have begun by the end of 2010.

Initial Guidance. In July 2009, Treasury released guidance on the cash grant program that included some rules on determining when construction has begun. For more information on that guidance, see our July 10, 2009 update, "[US Treasury Department Issues Guidance on Energy Grants In Lieu of Tax Credits](#)". Although the July 2009 guidance was helpful, a number of questions were left unanswered and parts of the guidance were unclear (especially with respect to the beginning of construction), which made it difficult for developers to plan their activities to ensure that projects would qualify if they were not to be placed in service before the end of 2010. Treasury issued the revised guidance to address some of the questions that were unanswered by, or have arisen since, the July 2009 guidance. Other than the changes to the rules regarding the beginning of construction, which appear in section IV.C of the program guidance, the July 2009 guidance was not changed.

Physical Work of a Significant Nature. According to both the July 2009 guidance and the revised guidance, construction begins "when physical work of a significant nature begins." The revised guidance adds that both on-site and off-site work may be taken into account in demonstrating that this standard has been met. The revised guidance provides some examples of what constitutes on-site physical work (e.g., the beginning of the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of concrete pads of the foundation) and off-site physical work (e.g., manufacture of components at an off-site location that will be delivered and assembled on-site). The revised guidance also provides some examples of what does not constitute physical work (e.g., preliminary activities such as planning or designing, securing financing, exploring, researching, clearing a site, test drilling of a geothermal deposit, test drilling to determine soil condition, or excavation to change the contour of the land).

Self-Construction vs. Construction by Contract. If the applicant manufactures, constructs, or produces property for use in its trade or business, then work performed by the applicant is taken into account in determining when physical work of a significant nature begins. If property is manufactured, constructed, or produced by third parties pursuant to a written binding contract that is entered into before the manufacture, construction, or production of the property to be used by the applicant, then work performed under the contract is taken into account in determining when physical work of a significant nature begins. The guidance does not provide any instruction on how to distinguish between self-construction and construction by contract.

Written Binding Contract. The revised guidance describes what qualifies as a written binding contract. To qualify, a contract must be binding under state law, it must not limit damages to less than 5 percent of

the total contract price, and it must specify the design specifications of the property to be purchased. A contract can be subject to a condition as long it is not within the control of the applicant or the vendor/manufacturer. A contract will continue to be binding despite modifications to the terms and conditions as long they are insubstantial. The revised guidance clarifies, by way of example, that adding a cold weather package under a wind turbine supply contract will be an insubstantial change that does not affect the binding nature of the contract. If there is a substantial modification to a contract, it appears that the contract will be treated as a new contract at the time of modification.

Safe Harbor. The most significant changes to the July 2009 guidance relate to the safe harbor rules. The revised guidance provides a safe harbor that allows an applicant to treat physical work of a significant nature as beginning when *more than* 5 percent of the total cost of the property has been paid or incurred. The revised guidance appears to allow costs to count when they are paid or incurred, regardless of whether the applicant is on a cash basis or an accrual basis, thereby removing a distinction made in the July 2009 guidance. In addition, the revised guidance appears to eliminate the economic performance rules of Internal Revenue Code Section 461(h) that were included in the July 2009 guidance. The revised guidance also provides that, if the applicant is a lessee of property under a pass-through lease, the safe harbor must be met by the lessor (unless applicant used a sale-leaseback).

In the case of self-construction, costs count toward the 5 percent threshold when they are paid or incurred by the applicant. Costs are incurred when the applicant becomes legally obligated to pay them. In the case of construction by contract, costs count toward the 5 percent threshold either when the property under the contract is provided to the applicant or when the vendor/manufacturer pays or incurs the costs (even though the applicant may not have paid the vendor/manufacturer). Presumably, a developer will require the vendor/manufacturer to certify how much it has paid or incurred through December 2010 in order to be able to demonstrate that the developer has met the 5 percent threshold. The guidance does not indicate whether the vendor/manufacturer's profit margin counts toward the 5 percent threshold. It appears that merely paying 5 percent of the costs to the vendor/manufacturer does not satisfy the safe harbor.

If the property includes both self-constructed components and components constructed by contract, the costs may be combined in determining whether the 5 percent threshold has been met. However, only costs included in the eligible basis of the specified energy property can be counted toward the 5 percent threshold.

An applicant may elect to use the safe harbor by stating so in section 2F of the grant application and describing the costs that satisfy the safe harbor. An applicant may rely on the July 2009 guidance for construction that began before March 15, 2010.

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