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Treasury Issues Additional Guidance Under Treasury Grant Program

The Treasury Department recently released revised guidance (the “Revised Guidance”) under section 1603 of the American Recovery and Reinvestment Act of 2009 — i.e., the Treasury Grant program for specified energy property. The Revised Guidance was issued in the same form as the original guidance issued in July 2009 (the “[Original Guidance](#)”), and adds to that Original Guidance and the [supplemental guidance](#) issued in January 2010. The Revised Guidance largely restates the Original Guidance, but substantially revises the section of the Original Guidance relating to the “beginning of construction” requirement for projects placed in service after 2010; see pages 6 and 7 of the [Revised Guidance](#).

Beginning of Construction Requirement

A Treasury Grant is provided for property either placed in service in 2009 or 2010 or placed in service after 2010, *but only if the construction of such property began during 2009 or 2010*. The Revised Guidance provides additional guidance relating to this beginning-of-construction requirement.

The Revised Guidance prefaces that construction begins when physical work of a significant nature begins. The

Revised Guidance states that work performed (i) by the applicant and (ii) by other persons under a written binding contract is taken into account in determining whether construction has begun. This clarifies the Original Guidance, which did not address the situation where work on property was conducted by both the applicant and other persons under contract. The Revised Guidance clarifies that the applicant may elect the 5 percent safe harbor to determine when construction begins and likewise take into account both work performed by the applicant and other persons under contract. Thus, the Revised Guidance permits the applicant to satisfy the beginning-of-construction requirement by (i) a facts-and-circumstances analysis of the physical work and significance of such work performed by the applicant and contracting parties with respect to the project or (ii) a cost analysis with respect to work done by the applicant and contracting parties.

Physical Work of a Significant Nature

The Revised Guidance specifies that both on-site and off-site work may be taken into account for purposes of demonstrating that physical work of a significant nature has begun. The Revised Guidance then provides an example of a wind turbine

generating facility that involves both on-site work and off-site work:

- On-site physical work of a significant nature begins with the beginning of the excavation for the foundation, the setting of anchor bolts into the ground or the pouring of the concrete pads of the foundation.
- If the facility's wind turbines and tower units are to be assembled on-site from components manufactured off-site and delivered to the site, physical work of a significant nature begins when the manufacture of the components begins at the off-site location.

The Revised Guidance restates the Original Guidance, providing that physical work of a significant nature does not include 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 excavating to change the contour of the land (as distinguished from excavation for footings and foundations).

Manufacturers of Components

The Revised Guidance states that if a manufacturer produces components for multiple facilities, reasonable methods must be used to associate individual components with particular facilities. Thus, in order to take into account the work being performed by component manufacturers, the applicant must provide for the *designation* of the components for the specified energy property.

Self-Construction and Construction by Contract

The Revised Guidance restates the Original Guidance on self-construction and construction by contract.

In the case of self-construction, the Revised Guidance provides that the work performed by the applicant is taken into account in determining when physical work of a significant nature begins.

In the case of construction by contract, the Revised Guidance provides that the work performed under the contract is taken into account in determining when physical work of a significant nature begins.

The Revised Guidance restates almost verbatim the requirements for a written binding contract from the Original Guidance. The Revised Guidance, however, provides some additional explanation to the Original Guidance. Specifically, the Original Guidance provides that a contract will continue to be binding if the parties make insubstantial changes in its terms and conditions or any term is yet to be determined by a standard beyond the control of either party. The Revised Guidance states, as an example, that minor modifications to the design specifications of property to be produced under a contract, such as a cold weather package for wind turbines, do not affect the binding nature of the contract.

The key revision from the Original Guidance in the Revised Guidance is to steer away from the dichotomy of self-construction and written binding contract that was apparent in the Original Guidance. Rather, the Revised Guidance focuses on the

totality of the physical work being done with respect to the specified energy property, whether that work is being performed by the applicant as part of self-construction (project or component) or construction by contract (project or component). Moreover, the applicant does not need to satisfy the beginning of construction requirement on a component-by-component basis. In addition, the applicant may rely on one component of the specified energy property or a combination of components to satisfy the requirement. This is an important clarification/revision.

Safe Harbor

The Revised Guidance carries over the 5 percent safe harbor in the Original Guidance. Thus, an applicant may treat physical work of a significant nature as having begun when more than 5 percent of the total cost of the property has been paid or incurred. The Revised Guidance, however, revises when these costs are paid or incurred — eliminating certain of the more onerous requirements for accrual of costs required by the incorporation in the Original Guidance of the “economic performance” requirements of Internal Revenue Code Section 461(h).

In the case of property constructed by the applicant, costs of the property are treated as paid or incurred when paid or incurred by the applicant.

In the case of property manufactured, constructed or produced for the applicant by another person under a written binding contract that is entered into prior to the manufacture, construction or production of the property:

- the cost of the property under the contract is treated as paid

or incurred when the property is provided to the applicant, and

→ for periods before the property is provided to the applicant, costs paid or incurred with respect to the property by such other person are treated as costs of the property that are paid or incurred *when paid or incurred by such other person*.

These revisions provide significantly more flexibility for applicants for purposes of meeting the 5 percent safe harbor.

In addition, the Revised Guidance clarifies that if the property includes both self-constructed components and components constructed under a contract, the costs relating to the self-constructed components and components constructed under a contract are *combined* in determining if the 5 percent of total costs have been exceeded. Thus, the safe

harbor incorporates an aggregate approach and takes into account both forms of construction.

The Revised Guidance states that all costs included in the eligible basis — referring to section V of the Revised Guidance — of the specified property and *only such costs* are taken into account in determining if 5 percent of the total costs have been exceeded. Section V of the Revised Guidance refers to the cost basis of property described in Code Section 1012, which includes capitalized physical and nonphysical costs. This is a significant revision from the Original Guidance, which did not include nonphysical capitalized costs (e.g., planning, design, financing, exploration and research costs) for purposes of the safe harbor.

The Revised Guidance also states that in the case of an election by a lessor of specified energy property to “pass through” the Treasury Grant to a lessee, the 5 percent safe harbor must be

satisfied *by the lessor*. However, in the case of a sale and lease back to the applicant, the applicant — as lessee — must satisfy the 5 percent safe harbor.

The Revised Guidance provides procedures for the applicant to make the election to apply the 5 percent safe harbor. According to the Revised Guidance, the applicant may elect to use the 5 percent safe harbor by stating in section 2F of the Treasury Grant application that the applicant is electing this safe harbor and describing the costs that satisfy the requirements for this election (and also provide the required documentation specified in section 6B of the application).

Reliance on July 2009 Guidance

The Revised Guidance provides that an applicant may determine when construction begins under the program guidance in effect before March 15, 2010.

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