

Client Alert

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Hunton & Williams LLP's Tax Team Secures Section 1603 Victory for Clients

On March 31, 2015, in *RP1 Fuel Cell, LLC and UTS SJ-1, LLC v. United States*, Judge Marian Blank Horn of the US Court of Federal Claims held that the plaintiffs were entitled to Section 1603¹ Treasury Grant amounts reduced by the Department of Treasury in relation to two fuel cell power plants designed and constructed to be operated on biogas from wastewater treatment sludge anaerobic digesters. During the grant award process, Treasury reduced the grant paid to the plaintiffs on the ground that the gas conditioning equipment used to condition the biogas and remove impurities so that it could be used in the fuel cells was not "qualified fuel cell property." The plaintiffs filed suit in the US Court of Federal Claims to recover the grant amounts withheld by Treasury for this equipment.

Under the Section 1603 Treasury Grant program, energy facilities that were placed in service or had begun construction between 2009 and 2011 qualify for cash grants of 30 percent of the basis of certain "specified energy property" in lieu of the Investment Tax Credit under Section 48 of the Internal Revenue Code (the "Code"). The language of Section 1603 provides that "specified energy property" includes any qualified fuel cell property under Code Section 48(c)(1). Subsequent guidance issued by Treasury additionally provides that specified energy property includes tangible personal property that is an "integral part" of the facility. The plaintiffs argued that the gas conditioning equipment was integrated balance of plant equipment with the fuel cell stack assemblies. The plaintiffs argued in the alternative that the equipment qualified for the grant as an integral part of a "trash facility" that uses municipal waste to generate electricity.

In a detailed and comprehensive opinion, Judge Horn held that certain gas conditioning equipment used in conjunction with anaerobic digester gas constituted part of the "fuel cell power plant" under Code Section 48(c)(1)(C). Judge Horn further found that the gas conditioning equipment was an "integral part" of the fuel cell power plant. Additionally, Judge Horn found that the fuel cell facilities also met the definitional requirements to be considered "trash facilities" under Code Section 45(d)(7).

The Department of Justice, litigating on behalf of the Department of Treasury, had argued that the gas conditioning equipment did not fit within the definition of fuel cell power plant. Additionally, the Department of Justice asserted that the plaintiffs' alternate argument — that the gas conditioning equipment was an "integral part" of the facility, as that term is understood in Treasury Regulation Section 1.48-1(d)(4) — was misguided because the language in the regulations was promulgated in reference to a part of Code Section 48 that was subject to a 1990 sunset provision. The court rejected these arguments. With respect to the Department of Justice's primary argument, Judge Horn determined that the intended use of the facility must be taken into account in determining whether any unit of property is qualified energy property. Here, the court determined that the intended use of the fuel cell power plants was to generate electricity using the digester biogas as a fuel. The gas conditioning equipment was integral to that intended use. The court stated:

¹ Such grants were issued under Section 1603 of the American Recovery and Reinvestment Tax Act of 2009, P.L. 111-5, §1603, 123 Stat. 115, 364 (Feb. 17, 2009), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat 3296, 3312 (December 17, 2010).

The record [. . .] indicates that plaintiffs' gas conditioning equipment is part of "an integrated system comprised of a fuel cell stack assembly and associated balance of plant components which converts a fuel into electricity using electrochemical means." I.R.C. § 48(c)(1)(C). The key terms in the statute, "integrated system," "balance of plant," and "fuel," should be understood to include the components necessary to the fuel cell facilities' intended operation on anaerobic digester biogas. * * * The court considers the gas conditioning equipment at issue in this case as part of a "fuel cell power plant," and, thus, as part of a "QUALIFIED FUEL CELL PROPERTY" under Section 1603(d)(2). (emphasis in original).

With respect to the Department of Justice's alternate argument, Judge Horn noted that "although the underlying provision of the Internal Revenue Code related to the 'integral part' test may have been subject to sunset, the regulation still exists, and appears to be in use today." Judge Horn further noted that, according to the guidance issued by Treasury in relation to the 1603 Grant Program, "[p]roperty is an integral part of a qualified facility if the property used directly in the qualified facility and is essential to the completeness of the activity performed in that facility." Judge Horn ultimately determined that the gas conditioning equipment at issue fit this definition of being an "integral part" of the facility.

The parties also asserted arguments on an alternative issue of whether or not the RP1 and SJ-1 facilities would qualify for the grant as "trash facilities" described in Code Section 45(d)(7). Judge Horn noted that "[t]he record reflects that the adjacent digesters and RP1 and SJ-1 fuel cell facilities can be considered, in combination, as one integrated unit." She further found that:

A review of the record and statutes [. . .] indicates that the sludge, wastewater sludge and biosolids that enter an anaerobic digester fit within the definition of solid waste under 42 U.S.C. § 6903(27), and are municipal solid waste under I.R.C. § 45(c)(6). As a result, the RP1 and SJ-1 fuel cell facilities, "integrated" with the anaerobic digesters at the IEUA Regional Plant No. 1 and San Jose Water Pollution Control Plant, qualify as "[t]rash facilities" pursuant to I.R.C. § 45(d)(7). (emphasis in original)

Judge Horn ultimately held that the facilities met the definitional requirements to be considered as "trash facilities" but concluded that "the record was not sufficiently developed to determine the plaintiffs' grant entitlement under a 'Trash Facility' qualification."

This opinion emanating from the US Court of Federal Claims marks the first time that a court has decided a 1603 Treasury Grant case after a full trial and briefing. Moreover, it marks the first dispositive court decision on a 1603 Treasury Grant issue that reaches a favorable result for the taxpayer.

Read a copy of the Court of Federal Claims' decision in [RP1](#).

Tim Jacobs, David Lowman and Hilary Lefko of the tax controversy team at Hunton & Williams LLP litigated the *RP1* case. Our tax controversy team consists of experienced practitioners and litigators. [Read our tax controversy practice description.](#)

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