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## GRANTS IN LIEU OF ENERGY INVESTMENT CREDITS AND APPLICATION TO LEASES

### ENERGY ALERT

#### INTRODUCTION

In early July, the Department of the Treasury issued a 20-page guidance document (<http://www.treas.gov/recovery/docs/guidance.pdf>) on cash grants in lieu of energy investment tax credits. The guidance covers applications for grants, eligibility of property, eligibility of claimants for the cash grants and recapturing of grants. The guidance document was accompanied by a 6-page application form (<http://www.treas.gov/recovery/docs/Application.pdf>) and a Terms and Conditions document, (<http://www.treas.gov/recovery/docs/energy-terms-and-conditions.pdf>) which is essentially a contract between the party seeking the grant and the Treasury Department. The guidance acknowledges that a lessor of eligible property (referred to as "specified energy property") may obtain a grant and that, in certain cases, the lessor can transfer to the lessee the right to obtain the grant.

The American Recovery and Reinvestment Act of 2009 (ARRA) permits taxpayers to receive a grant from Treasury in lieu of claiming certain energy investment tax credits (including investments tax credits that ARRA permits to be claimed in lieu of production tax credits) for renewable and alternative energy property. The grants generally equal the amount of the credit that the taxpayer could have claimed if the taxpayer had the ability to fully utilize the credit. Grants are available for (i) property placed in service in 2009 or 2010 and (ii) property the construction of which began in 2009 or 2010 if the property is placed in service before the credit termination date for the property.

*Caution:* Qualified property includes only tangible property that is both used as an integral part of the activity performed by the qualified facility and located at the site of qualified facility. Qualified property does not include a building, but it may include structural components of a building.

Only costs that are capitalized can be taken into account in determining the amount of the grant. If the owner claims a section 179 expensing deduction for part of the cost of a facility, that portion of the cost is not taken into account in determining the amount of the grant.

The guidance states that applications must be submitted after the property has been placed in service and before October 1, 2011, or, if the property is to be placed in service after September 30, 2011, by October 1, 2011. The applicant must have a DUNS number from Dun & Bradstreet and must register with the Central Contractor Registration (CCR).

#### GRANTS WITH RESPECT TO LEASED PROPERTY

The guidance specifically recognizes that grants may be issued with respect to leased property. The owner/lessor of the leased property may claim the credit. Alternatively, the owner of the leased property may make an irrevocable election to let the lessee claim the grant. The election would be made by written agreement between the lessee and lessor and would generally follow the rules of the Internal Revenue Code applicable to a lessor passing a credit through to the lessee. The lessee must agree to include ratably in gross income over 60 months an amount equal to 50 percent of the grant. (This corresponds to the basis reduction that owner must take by reason of claiming a grant or energy investment tax credit.)

*Caution:* The applicant will be required to provide the Treasury with a copy of the signed agreement, so it may be best to include the agreement in a document separate from the lease.

The guidance prohibits mutual savings banks and other similar financial organizations, regulated investment funds and real estate investment trusts (REITs) from passing the right to claim the grant to lessees.

*This Energy Alert provides only general information and should not be relied upon as legal advice. For more information, contact your Patton Boggs LLP attorney or one of the lawyers/authors listed below.*

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As a general rule, a grant may be claimed only by the original user of the property. However, a special sale-leaseback rule enables the owner-lessor to seek the grant if the lessee places the property in service and sells and leases it back within three months of the original placed-in-service date.

## RECAPTURE RULES

The guidance indicates that grants are subject to recapture (i.e., an obligation to repay all or a portion of the grant to Treasury) if the property is sold to a “disqualified person” or the property ceases to qualify as property that would have been eligible for a grant (e.g., because the property is being used for a different purpose). Twenty percent of the grant vests on each anniversary of the placed-in-service date, so that a transfer to a disqualified person after the fifth anniversary of the placed-in-service date will not result in recapture.

The term “disqualified person” includes governmental and tax-exempt organizations.

A partnership or other pass-through entity that passes through income or losses to a disqualified person is treated as a disqualified person unless all disqualified persons hold their interests through taxable C corporations. The guidance clarifies that for these purposes REITs and cooperatives are not pass-through entities.

The guidance indicates that a sale of property to a person who is not disqualified does not result in recapture if the property continues to be qualified and the purchaser agrees to be jointly liable with the seller for recapture.

Under the guidance, if a lessor transfers to the lessee a right to apply for the grant and the lessee receives the grant, the lessee will be liable for the recapture amount if the lessor subsequently sells the property to a disqualified person.

If a grant has been claimed with respect to property under a lease and possession of the property changes (either by reason of termination of the lease or the lessee’s transfer of its rights under the lease) before the grant is fully vested, the grant will be subject to recapture if the use of the property changes so that the property would no longer be qualified property. In that case, the party claiming the credit would be liable for the recapture.

This means that lease agreement should include the same types of covenants and indemnities that were included in leases of property subject to the investment tax credit when there was a general investment tax credit and that are included in leases today of property eligible for an energy investment tax credit.

The obligation to repay a grant in the case of an event leading to recapture is unsecured. The Treasury will not be taking security interests in property to secure the potential repayment obligation.

## ASSIGNMENT OF GRANTS

Applicants for grants may assign the grant payments to third parties by providing a Notice of Assignment and complying with the Federal Assignment of Claims Act (31 U.S.C. 3727).

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