

**Payments for Specified Energy Property in Lieu of Tax Credits  
Under the American Recovery and Reinvestment Act of 2009**

**FREQUENTLY ASKED QUESTIONS AND ANSWERS**  
**BEGUN CONSTRUCTION**

Q1. How does an applicant demonstrate that construction has begun on a project in 2009, 2010 or 2011?

A1. There are two ways to show that construction has begun. One is to begin physical work of a significant nature. The other is to meet a 5% safe harbor.

**Physical Work of a Significant Nature**

Q2. What does it mean to begin physical work of a significant nature?

A2. This means that physical work on the specified energy property has started. Physical work of a significant nature includes any physical work on the specified energy property at the site. Physical work of a significant nature also includes physical work that has taken place under a binding written contract for the manufacture, construction, or production of specified energy property for use by the applicant's facility provided the contract is entered into prior to the work taking place.

Q3. What is included in specified energy property in the case of a qualified facility described in section 45 of the Internal Revenue Code?

A3. In the case of a qualified facility described in section 45, specified energy property is limited to tangible personal property and other tangible property used as an integral part of the activity performed by the qualified facility and located at the site the qualified facility. For such a facility, specified energy property includes property integral to the production of electricity, but does not include property used for electrical transmission. Thus, physical work on a transmission tower located at the site is not physical work of a significant nature because the transmission tower is not part of the qualified facility. However, physical work on a transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission is physical work of a significant nature because power conditioning equipment is part of the qualified facility.

Q4. How much physical work is required? Is laying the foundation for one wind turbine that is part of a larger wind farm sufficient?

A4. In general any physical work on the specified energy property will be treated as the beginning of construction even if such work relates to only a small part of the facility, but see Q5/A5 below.

Q5. Once physical work has begun, must physical work on the project be continuous to satisfy the requirement that construction has begun? For example, if a single foundation for a wind

turbine is laid in 2011 but no other physical work on a 50-turbine project takes place until 2013, has the requirement been met?

A5. Treasury will closely scrutinize any construction activity that does not involve a continuous program of construction or a contractual obligation to undertake and complete within a reasonable time, a continuous program of construction. Disruptions in the work schedule that are beyond the applicant's control (for example, unusual weather or a site at which work can only be performed during certain seasons) will be taken into account in determining whether or not an applicant has undertaken a continuous program of construction.

Q6. Is starting work on roads physical work of a significant nature?

A6. Only work on specified energy property is physical work of a significant nature for purposes of showing that construction has begun. In the case of a qualified facility described in section 45, roads on the site that are integral to the qualified facility are specified energy property; these include onsite roads that are used for moving materials to be processed (for example, biomass) and roads for equipment to operate and maintain the qualified facility. Starting construction on these roads constitutes the beginning of construction. Roads for access to the site, or roads used solely for employee or visitor vehicles are not specified energy property; starting construction on these roads is not starting physical work of a significant nature on specified energy property.

Q7. Is preliminary work such as clearing land, obtaining permits or putting up fencing physical work of a significant nature?

A7. Preliminary work such as clearing land and obtaining permits is not physical work of a significant nature on specified energy property. Erecting a fence (or beginning to erect a fence) is not the beginning of physical work of a significant nature because, generally, fencing is not an integral part of the qualified facility.

Q8. An applicant plans to build a new facility for the production of electricity from wind power. The facility will be constructed on an existing wind facility site. In order to construct the new wind facility, the existing facility will be dismantled and removed. If an applicant begins to remove portions of the existing facility has physical work of a significant nature commenced?

A8. No. Generally, the cost of removal is associated with the property being removed or is capitalized to non-depreciable land. Removal of the existing turbines and towers is preliminary work and, therefore, does not constitute physical work of a significant nature on specified energy property.

Q9. Is the construction at the site of a building that will be used for operations and maintenance physical work of a significant nature?

A9. Because a building is not specified energy property, construction of a building is not physical work of a significant nature. However, the following structures are not treated as buildings for this purpose: (1) a structure that is essentially an item of machinery or equipment, or (2) a structure that houses property used as an integral part of a qualified activity if the use of the structure is so closely related to the use of the housed property that the structure clearly

can be expected to be replaced when the property it initially houses is replaced. See Treas. Regs. § 1.48-1(e)(1).

Q10. Is test drilling of a geothermal deposit considered physical work of a significant nature?

A10. Test drilling for a geothermal deposit is a preliminary activity and is not physical work of a significant nature.

Q11. When is a contract binding?

A11. To be binding, a contract must be enforceable under state law. Additionally, the contract terms cannot limit damages in the event of a breach to less than 5% of the total contract price.

Q12. What is included in work performed under a binding written contract?

A12. Work performed under the contract includes only work that takes place after the binding written contract is entered into. The work is treated as physical work of a significant nature only if it is work on property that will become specified energy property of the applicant. For example, if a contractor is manufacturing solar panels specifically for the applicant under a binding written contract, any physical work on those panels is physical work of a significant nature on specified energy property of the applicant. If an applicant has a binding written contract with a contractor who is manufacturing solar panels for a number of customers, physical work on the panels would only be considered work performed under the applicant's binding written contract if the contractor can reasonably demonstrate that physical work has started on panels that will become specified energy property of the applicant. The contractor may use any reasonable, consistent method to allocate work it performs among its customers. Whether a method is reasonable depends on all the relevant facts and circumstances.

Q13. If an applicant purchases components or other parts from the inventory of a vendor under a binding written contract entered into before January 1, 2012, has physical work of a significant nature begun?

A13. No. Work performed under a contract does not include work to produce components or parts that are in existing inventory or are normally held in inventory by a manufacturer.

Q14. If physical work takes place pursuant to a binding written contract on property manufactured, constructed or produced for the applicant's project but the specific site for the project will not be identified prior to the deadline for submitting initial applications (or the site changes after an initial application is submitted), has physical work of a significant nature begun?

A14. If the work performed otherwise meets the requirements for physical work of a significant nature and work on the project is continuous (see Q5/A5), the fact that the specific site of the project has not been identified at the time of the initial application (or changes after the initial application) does not impact whether or not construction has begun.

### **5% Safe Harbor**

Q15. How is the 5% safe harbor met?

A15. An applicant meets the 5% safe harbor if the applicant pays or incurs 5.00% or more of the total cost of the specified energy property before the end of 2011.

Q16. What does “paid or incurred” mean?

A16. The term “paid or incurred” generally means paid or incurred within the meaning of Treas. Regs. §1.461-1(a)(1) and (2). That is, costs are taken into account when cash-method taxpayers “pay” them and when accrual-method taxpayers “incur” them. A cost is generally “incurred” for tax purposes when 1) the fact of the liability is fixed, 2) the amount of the liability is determinable with reasonable accuracy, and 3) the economic performance test (see Treas. Regs. §1.461-4) has been met with respect to such cost. Although the specific reference to the §461(h) economic performance rules was deleted in the revised Program Guidance, the economic performance rules continue to apply in determining whether costs have been incurred. The 5% safe harbor contained in the Program Guidance includes a single exception to the general principles that are used to determine when amounts are “incurred.” Under general rules for property manufactured, constructed, or produced for the applicant by another person under a binding written contract that is entered into prior to the manufacture, construction, or production of the property, the cost of such property is treated as “incurred” when the property is provided to the applicant. The exception is that for periods before the property is provided to the applicant, costs incurred with respect to the property by such other person are treated as costs of the property that are incurred by the applicant when the costs are incurred by such other person.

Q16A: When are costs paid or incurred by the person providing the property to the applicant under a binding contract?

A16A: Costs are paid or incurred by the person providing property to the applicant as that person pays or incurs costs in connection with providing property to the applicant. For example: In 2011, accrual-method taxpayer W enters a binding written contract to provide a wind turbine to A in June 2013. In 2011, W, pursuant to a contract with Y, pays Y to provide parts in May 2012 for use in the wind turbine. W’s employees provide W with services necessary to design and plan for the production of the wind turbine in 2011 and with services to manufacture (assemble) the wind turbine in 2013. W incurs the cost to design and plan for the production of the turbine assembly in 2011, incurs the costs for the parts in May 2013 when Y delivers the parts to W, and incurs the costs for W’s employees to assemble the wind turbine in 2013. See § 1.461-4(d)(4), § 1.446-1(c)(1)(ii), and Example 3 of § 1.461-4(d)(7) of the Income Tax Regulations. For purposes of determining whether A has met the 5% safe harbor, A may only include the costs incurred by W to pay its employees to plan and design the turbine in 2011.

Q17. If title to the property has passed to the applicant, but the property remains in storage at the manufacturer’s site, has the property been provided to the applicant?

A17. Property is provided to the applicant either when title to the property passes to the applicant or when it is delivered to or accepted by the applicant, depending on the applicant’s method of accounting. In addition, property that the applicant reasonably expects to be

provided within 3-1/2 months of the date of payment will be considered to be provided on the payment date. See, generally, Treas. Regs. §1.461-4(d)(6).

Q18. In the case of property manufactured, constructed, or produced for the applicant by another person (the supplier) under a binding written contract that is entered into prior to the manufacture, construction, or production of the property, how does the applicant determine what costs have been paid or incurred on its behalf by the supplier? (Note that this Question and Question 19 assume that the supplier uses the accrual method of accounting)

A18. The applicant may rely on a statement by the supplier as to the amount incurred by the supplier with respect to the property to be manufactured, constructed, or produced for the applicant under the binding written contract. The supplier may use any reasonable, consistent method to allocate the costs incurred by the supplier among the units of property to be manufactured, constructed, or produced by the supplier. Only costs incurred by the supplier after the binding written contract is entered may be reasonably allocated to the property manufactured, constructed, or produced under that contract. The economic performance rules apply to determine when costs have been incurred by the supplier. The exception described in Q16/A16 does not apply in determining when costs are incurred by the supplier. Thus, if components are manufactured for the supplier by a subcontractor, the cost of those components is incurred only when the components are provided to the supplier and not as the subcontractor pays or incurs the costs of manufacturing the components.

Q19. An applicant may enter into a binding written contract for multiple units of property to be manufactured, constructed, or produced for the applicant by another person under a binding written contract that is entered into prior to the manufacture, construction, or production of the property. How does the applicant allocate the costs paid or incurred with respect to the contract to the units of property acquired pursuant to the contract?

A19. Costs incurred when property is delivered to the applicant are allocated to such property. Costs that are treated under Q16/A16 as incurred when incurred by the supplier with respect to the property are allocated to the property with respect to which the supplier incurred the costs. The supplier may use any reasonable method to allocate the costs it incurs among the units of property manufactured, constructed or produced by the supplier and to allocate the units of property it produces among its customers. Whether a method is reasonable depends on all the relevant facts and circumstances. In addition, property that the supplier reasonably expects to receive from a subcontractor within 3-1/2 months of the date of the supplier's payment to the subcontractor is considered to be provided by the payment date. See, generally, Treas. Regs. §1.461-4(d)(6).

Q20. A developer may enter into a binding written contract for multiple units of property to be manufactured, constructed, or produced for the developer by another person under a binding written contract (a "master contract") that is entered into prior to the manufacture, construction, or production of the property. The developer may then assign its rights to certain units of property to an affiliated special purpose vehicle (generally, a limited liability company) that will own the project for which such property is to be used and will apply for the payment. Such assignment typically is represented by a new contract (the "project contract") between

the special purpose vehicle and the person manufacturing, constructing, or producing the property. An adjustment is then made to the master contract between the developer and the person manufacturing, constructing, or producing the property to reflect the assignment. Assume costs paid or incurred with respect to the master contract between the developer and the person manufacturing, constructing, or producing the property are considered to have been paid or incurred in 2009, 2010, or 2011 for purposes of determining whether construction has started. For purposes of determining whether construction has started, may these costs then be allocated to the special purpose vehicle if its project contract and the master contract, as adjusted, both reflect this assignment?

A20. Costs that are allocated to the property under the principles of Q19/A19 are treated as costs of the property notwithstanding the substitution of the project contract with respect to such property.

Q21. What happens if the project's costs are more than expected? Is it sufficient to show that an applicant reasonably expected costs paid or incurred before the end of 2011 to be 5% of the project costs?

A21. No. To satisfy the 5% safe harbor applicants must demonstrate that costs paid or incurred before the end of 2011 are equal to or greater than 5% of the actual total costs of the specified energy property. However, if the applicant's project includes multiple units of specified energy property, an applicant can opt to apply for a payment based on some, but not all, units of property. For example, if an applicant incurs \$25,000 in costs in 2011 for specified energy property in a 5 turbine wind farm anticipating total costs for specified energy property of \$500,000 but the actual total costs of specified energy property amount to \$600,000, the safe harbor would not be satisfied. However, the applicant can opt to apply for a payment based on the costs of 3 turbines and would satisfy the safe harbor if the \$25,000 of costs incurred in 2011 relates to the 3 turbines and their total cost does not exceed \$500,000.

Q22. An applicant demonstrates that the applicant meets the 5% safe harbor as of December 31, 2011, with respect to a facility. The facility will not be placed in service until 2012. Must the applicant continue to work at the site in 2012 in order to qualify for payment in 2013?

A22. No.

Q23. For applicants relying on the 5% safe harbor, what happens if ownership of the energy property changes between the time the property is acquired for use in a project and the time the project is placed in service?

A23. If a person (the transferor) contributes, assigns or transfers property to a second person (the transferee) and the transferee uses the property in a project, the transferee is treated for purposes of the 5% safe harbor as having paid or incurred, at the same time as the transferor, the costs that the transferor paid or incurred to acquire the property, but only if the transferor acquired the property for use in that project and is related to the transferee. A transferee and transferor that are related persons within the meaning of section 197(f)(9)(C) of the Internal Revenue Code immediately before or immediately after the contribution, assignment, or transfer of the property will be considered related for this purpose. However, if property is sold to an unrelated purchaser after December 31, 2011, the purchaser may not take the costs that

the transferor incurred with respect to the property into account in determining whether the 5% safe harbor is met. This limitation does not apply in the case of a sale/leaseback arrangement. If an entity which met the 5% safe harbor with respect to a facility sells the facility to an unrelated entity and leases the facility back from that entity within 90 days of the placed in service date, the purchaser of the facility (assuming all other eligibility requirements are met) would be treated as satisfying the 5% safe harbor.

Q24. For applicants relying on the 5% safe harbor, what happens if ownership of the entity that met the 5% safe harbor changes before the property is placed in service?

A.24. If ownership of the entity that met the 5% safe harbor changes after December 31, 2011, and before the property is placed in service, eligibility is not affected if (1) the purchaser is an otherwise eligible Section 1603 applicant and (2) the entity being sold had commenced development of a project as evidenced by activity such as acquiring land, obtaining permits and licenses, entering into a power purchase agreement, entering into an interconnection agreement, and contracting with an Engineering, Procurement and Construction contractor. The purchaser of an entity which holds equipment only may not rely on costs paid or incurred to acquire that equipment. For example, a project company meets the safe harbor and commences development of a project by acquiring permits, a power purchase agreement and an interconnection agreement. A partnership interest in the project company is sold to a tax equity investor (or the tax equity investor makes a capital contribution in exchange for a partnership interest) in a partnership flip transaction. The project company (with the tax equity investor as a partner) may rely on costs incurred by the project company to satisfy the 5% safe harbor. On the other hand, if a project company meets the safe harbor by purchasing and taking delivery of equipment but does no other activity, the purchaser of the project company may not rely on costs incurred by the project company to satisfy the 5% safe harbor.

## **Process**

Q25. Under what circumstances and when is an applicant required to submit an application demonstrating that construction has begun?

A25. All applications must be submitted before the statutory deadline of October 1, 2012. For property that has been or will be placed in service in 2009, 2010, or 2011 an application demonstrating that construction has begun is not required. For property that is placed in service after December 31, 2011, but before October 1, 2012, applicants may submit an application before October 1, 2012, demonstrating both that construction began on the property in 2009, 2010, or 2011 and that the property has been placed in service. For property that is placed in service on or after October 1, 2012, applicants must submit a preliminary application before October 1, 2012, demonstrating that construction on the property began in 2009, 2010, or 2011. Such applications must then be supplemented at the time the property is placed in service.

Q26. If an applicant submits an application demonstrating that construction has begun, will the applicant receive a response?

A26. Yes. Although we cannot provide assurance that an applicant meets all the requirements for a payment until all facts and circumstances are known (at time the facility is placed in service), we will tell the applicant whether or not the work performed is physical work of a significant nature or, for applicants relying on the safe harbor, whether qualifying costs have been paid or incurred.

Q27. What documentation is required?

A27. For projects relying on “physical work of a significant nature” applicants must document the physical work. For example, to demonstrate that physical work of a significant nature has commenced at the site, applicants should submit a written report from the project engineer or installer, signed under penalties of perjury, describing the project’s eligibility; including a detailed construction schedule; estimated budget for the project and a description of the work that has commenced including any invoices for the work performed. For projects with an anticipated cost basis of \$1 million or more, the report must be from an independent engineer. To demonstrate that physical work of a significant nature has commenced under a binding written contract, applicants should submit a copy of the binding written contract and a statement from the contractor, signed under penalties of perjury, describing the work that has commenced and certifying that the work commenced pursuant to the binding written contract.

For projects relying on the 5% safe harbor, applicants must submit a statement from an authorized representative of the applicant signed under penalties of perjury, or for projects with an estimated eligible cost basis of \$1 million or more, from an independent accountant, attesting to the method of accounting used by the applicant for federal tax purposes (cash or accrual). For applicants that use the cash method of accounting, the statement should state the amount that has been paid before the end of 2011; a detailed description of the costs that have been paid; and an estimate of the total cost of the specified energy property and must include evidence of payment such as invoices or other financial records. For applicants that use the accrual method of accounting, the statement should state the amount that has been incurred before the end of 2011; a detailed description of the costs incurred; and an estimate of the total cost of the specified energy property and must include evidence of the costs incurred such as invoices or other financial records. If an applicant is relying on costs paid or incurred by a contractor, a copy of the binding written contract and a statement from the contractor, signed under penalty of perjury, of costs paid or incurred and allocated to applicant’s project must be included.

Additional documentation may also be required depending on the facts and circumstances. If additional documentation is required applicants will be notified.