

Section 1603 Sequestration and Its Effect on the Investment Tax Credit and the Production Tax Credit

Notice 2014-39

SECTION 1: PURPOSE

This notice clarifies for taxpayers the tax effect of sequestration as it relates to a grant awarded under Section 1603 of the American Recovery and Reinvestment Tax Act of 2009 (ARRTA), Division B of Pub. L. 111-5, 123 Stat. 115 (2009), as amended by (i) section 707 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312, 124 Stat. 3296 (2010), and (ii) section 407(c)(2) and (d)(3) of the American Taxpayer Relief Act of 2012 (ATRA), Pub. L. 112-240, 126 Stat. 2313 (2013) (hereinafter in this notice, Section 1603 as amended is referred to as Section 1603 of ARRTA or Section 1603).

SECTION 2: BACKGROUND

.01 *In general.* The Internal Revenue Code of 1986 (Code) provides certain incentives for renewable energy generation, including a production tax credit under section 45 (PTC) and an investment tax credit under section 48 (ITC). ARRTA modified section 48 to allow taxpayers to claim an ITC in lieu of a PTC with respect to certain property. ARRTA also created a new grant program (Section 1603 Program) allowing applicants to elect to receive a cash grant from the Treasury Department (Treasury) in lieu of tax credits.

.02 PTC: Section 45 of the Code. Section 45 of the Code provides a PTC for the production and sale of electricity from certain renewable energy resources.

.03 ITC: Section 48 of the Code. Section 48 of the Code provides an ITC for certain energy property. Generally, under section 48(a)(1), the ITC for any taxable year is the energy percentage of the basis of each energy property, as defined in section 48(a)(3), placed in service during such taxable year. Section 48(a)(5) of the Code allows a taxpayer to elect to treat certain qualified facilities (that qualify for the PTC) as energy property (eligible for the ITC). In general, a taxpayer may elect in the case of any qualified property that is part of a qualified investment credit facility that such property be treated as energy property for purposes of section 48.

.04 Section 1603 of ARRTA. Section 1603 of ARRTA establishes the Section 1603 Program. Generally, under Section 1603(a), the Secretary of the Treasury will provide grants to eligible persons who place in service specified energy property and apply for such payments. Grants are awarded under Section 1603 to reimburse eligible applicants for a portion of the expense of such property.

Under Section 1603(b)(1) of ARRTA, the amount of the grant under Section 1603(a) with respect to any specified energy property is the applicable percentage of the basis of such property. For purposes of Section 1603(b)(1), the term “applicable percentage” means 30 percent in the case of property described in Section 1603(d)(1) through (4), and 10 percent in the case of any other property (as described in Section 1603(d)(5) through (8)).

.05 Interaction of Section 1603 of ARRTA with the ITC and the PTC. Section

48(d)(1) of the Code provides that in the case of any property with respect to which the Secretary makes a grant under Section 1603 of ARRTA, no credit shall be determined under section 48 or 45 with respect to such property for the taxable year in which such grant is made or any subsequent taxable year. Section 48(d)(3) provides that any such grant is not includible in the gross income of the taxpayer, but must be taken into account in determining the basis of the property to which such grant relates, except that the basis of such property must be reduced under section 50(c) in the same manner as a credit allowed under section 48(a).

.06 *Sequestration.* The Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA), Pub. L. 99-177, 99 Stat. 1037 (1985), as amended, requires sequestration of discretionary appropriations and direct spending. Specifically, the Budget Control Act of 2011 (BCA), Pub. L. 112-25, 125 Stat. 240 (2011), amended the BBEDCA by reinstating discretionary spending limits for 2012–2021. The limits are enforced by a sequestration of non-exempt discretionary budget authority that is ordered at the end of the current session of Congress if enacted appropriations exceed the limits. Under the BCA, sequestration was to begin on January 2, 2013. The ATRA postponed the BCA sequester until March 1, 2013. The applicable statutes exempt certain programs from sequestration; all programs not covered by an exemption are subject to sequestration. The Section 1603 program is not exempted.

SECTION 3: EFFECT OF THE SEQUESTER ON SECTION 1603 AWARDS

For purposes of this notice, the grant awarded under Section 1603 of ARRTA (the Section 1603 Award) is the amount that Treasury determines to be the applicable

percentage of the property's basis as evidenced by the letter from Treasury's Office of Fiscal Assistant Secretary (the Section 1603 Award Letter). The Section 1603 Award is effective the date of the Section 1603 Award Letter. The Section 1603 Award Letter provides the amount of the payment issued under Section 1603 of ARRTA for specified energy property in lieu of tax credits (the Section 1603 Payment), which generally is equal to the amount of the Section 1603 Award. However, pursuant to the requirements of BBEDCA (as amended), Section 1603 Awards are subject to sequestration, which may cause a Section 1603 Payment to differ from the corresponding Section 1603 Award. Under the provisions of BBEDCA (as amended), a Section 1603 Award made to a Section 1603 applicant on or after March 1, 2013, and on or before September 30, 2013, is subject to a sequestration rate of 8.7 percent, and a Section 1603 Award made to a Section 1603 applicant on or after October 1, 2013, and on or before September 30, 2014, is subject to a sequestration rate of 7.2 percent, irrespective of when the application was received by Treasury. Thereafter, the sequestration rate is subject to change.

SECTION 4: EFFECT OF REDUCED SECTION 1603 PAYMENT

.01 *In General.* The Section 1603 Payment resulting from sequestration during the affected time period does not affect the amount of the Section 1603 Award or the basis of the specified energy property taken into account for purposes of determining the Section 1603 Award. Under section 48(d)(1) of the Code, a taxpayer may not claim a credit under section 45 or 48 with respect to such property for the taxable year in which such Section 1603 Award is made or any subsequent taxable year.

Consequently, a taxpayer may not partition the basis of property for which it receives a Section 1603 Award and claim a tax credit under section 45 or 48 with respect to any part of the basis of the same property.¹ However, under section 48(d)(3)(B), a taxpayer must reduce the basis of the specified energy property by 50 percent of the amount of the actual Section 1603 Payment.

.02 *Example.* On August 1, 2012, a taxpayer submits an application to Treasury under Section 1603 of ARRTA for specified energy property (Property) that has a basis of \$100 million. On May 1, 2013, Treasury grants the taxpayer a Section 1603 Award as evidenced by a Section 1603 Award Letter. Because Property has a basis of \$100 million, the Section 1603 Award is \$30 million. However, due to the sequestration rate of 8.7 percent, the taxpayer receives a Section 1603 Payment of \$27,390,000. This reduced payment does not affect the amount of the \$30 million Section 1603 Award. The taxpayer may not claim a credit under section 45 or 48 on any part of the basis of Property. The taxpayer must reduce the basis of Property by 50 percent of the amount of the Section 1603 Payment, or \$13,695,000.

SECTION 5: EFFECTIVE/APPLICABILITY DATE

This notice applies to Section 1603 Awards issued on or after March 1, 2013, which is the beginning date of the sequestration as described in section 2.06 of this notice, and Section 1603 Payments made pursuant to those awards.

¹ The Terms and Conditions document that each Section 1603 Program applicant signs under penalties of perjury includes the following provision (section 4): “The applicant will not claim a tax credit under section 45 or section 48 of the IRC with respect to the property described in the application.”

SECTION 6: DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Martha M. Garcia of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Ms. Garcia on (202) 317-6853 (not a toll-free call).