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Court Issues Perplexing Decision in Alta Wind

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On June 20, the U.S. Court of Federal Claims issued an opinion and order, denying plaintiffs' motion for summary judgment in *Alta Wind I Owner-Lessor C, et al. v. U.S.* (Nos. 13-402, 13-917, 13-935, 13-972, 14-47, 14-93, 14-174, 14-175, 17-997). The plaintiffs had asked the court to rule as a matter of law that (1) the cash grant pursuant to Section 1603 of the American Recovery and Reimbursement Act of 2009 (Section 1603) is not a separate asset for purposes of Section 1060 of the Internal Revenue Code of 1986, as amended (Code); (2) the value of the grant must be included in the basis of the grant-eligible property; and (3) the plaintiffs' eligible basis may not be reduced on account of the associated indemnities.

The court's analysis and its conclusions on the first two issues (concerning the treatment of the grant itself) are inconsistent with precedent and established practice. Furthermore, the opinion and order address only a motion for summary judgment — *i.e.,* they are not a final disposition of the case. Accordingly, although the opinion is not a welcome development, it remains to be seen whether the opinion will have significant implications for renewable projects.

Background

Although *Alta Wind* concerns the Section 1603 grant, it remains relevant for investment tax credit (ITC) cases because the Section 1603 grant applies ITC rules and principles. At issue in *Alta Wind* is the appropriate amount of the Section 1603 grant for several wind facilities. The *Alta Wind* plaintiffs purchased wind farms from a developer, placed them in service, and then applied to the Treasury Department for $703 million in Section 1603 grants. The Treasury Department awarded Section 1603 grants of approximately $495 million based on a determination that a portion of the purchase price for the wind facilities should be allocated to intangibles, potentially including going concern value and goodwill, using the residual method under Section 1060 of the Code.

The opinion addresses the plaintiffs' motion for summary judgment. Summary judgment is proper if there is no genuine dispute as to any material fact, and the movant is entitled to judgment as a matter of law. To the extent summary judgment is not granted, the relevant issues remain unresolved until trial.

Overview of the Issues

The issues in the case should have been straightforward. It is beyond dispute that tax benefits, including for this purpose the Section 1603 grant, increase the intrinsic value of renewable energy property.

The first question for decision here is whether there is any rule that says to reduce basis for Section 1603 purposes by the amount of the grant. The answer is no. There is no statutory rule that requires a basis reduction.

In fact, contrary to the opinion, there is a statute on point that says the basis is *not* reduced by the grant. Nor is there any rule outside the statute that requires it. (For instance, existing law on rebates and other purchase price adjustments would not apply to this situation and were not, in any case, discussed in the opinion.) In the absence of a basis reduction rule, the otherwise applicable rules should apply, and there should be no basis reduction.

The second question is whether the grant represented an asset separate from the tangible property of a project. The answer is no — the grant is not separable from the tangible property because it does not come into being unless and until the project is placed in service (and the project was placed in service after the sale). The opinion, however, concludes that the grant is a separate intangible asset but does not define the nature of that intangible asset.

Analysis in the Opinion

To an audience versed in tax or energy (or both), the opinion is strange to read. In many places, the court seems to approach the analysis in reverse, analyzing the nature of the grant rather than the property to which the grant relates. Some items of note from the analysis are discussed here.

The court uses a textualist "plain meaning" approach to interpret Section 48(d)(3)(B), which says a Section 1603 grant "shall be taken into account in determining the basis of the property to which such grant relates … ." Despite this plain statutory language, the court concludes that the statute does not preclude reducing the basis by the amount of the grant.

The opinion uses terminology that obfuscates the issues. It's not quite right to say that the grant is (or is not) included in basis. The right way to phrase the questions at issue is (1) whether, for purposes of calculating the grant, basis is reduced by the amount of the grant and (2) whether some of the purchase price of a project should be allocated to an intangible asset related to the grant. To oversimplify, a taxpayer's basis is its cost for this purpose. Its cost is what it pays for property. By contrast, the grant represents revenue from the property. To say that the grant is (or is not) included in basis does not make sense, strictly speaking.

The court describes the grant as an intangible asset, but the opinion never considers what kind of asset it might be or states what Class of assets to put the grant in for Section 1060 purposes. The Section 1603 grant was based on the ITC, which at that time was nontransferable and nonrefundable (meaning it could only be used to offset tax liability). The ITC was not an asset, though arguably the Section 1603 grant could *mature* into an asset (a receivable) because it was ultimately payable in cash. But the grant is not an asset before the project has been placed in service. If a grant were an intangible asset that existed before the placed-in-service date, then presumably it would have a value equal to the present value of the grant. The logical extrapolation of that conclusion, though, would be that there would be intangible assets for all of the revenue streams from a project. The aggregate value of all such intangible assets would likely exceed the fair market value of the property (particularly because operating expenses are not considered in such an approach) before allocating any of the value to the property itself. This conclusion cannot be right, which suggests that the grant (just like the other revenue streams) is not an intangible asset.

The court repeatedly focuses on what it and the government call the "recursive" problem. This appears to be the idea that in determining the purchase price of a project, a buyer and seller would take into account the amount of the grant, which is itself determined by the amount of the grant. The court seems to think that this concept is absurd, and the self-referential nature of the calculation would never end. But that is not correct, and the calculation is in fact straightforward. To oversimplify somewhat, if a buyer is willing to pay $70 for a project with no grant, it might be willing to pay $100 for a project with the grant ($70/(1-30%)). This is another variation on the familiar tax gross-up calculation. The government's position, with which the court agreed, is that the buyer should only be willing to pay $91 for the project ($70 + ($70 * 30%)), contrary to established valuation practice.

The logic in the opinion is inconsistent with how buyers value the tax benefits of energy projects. The court inexplicably distinguishes a series of cases acknowledging that tax benefits are included in the value of acquired assets. The court, therefore, fails to acknowledge that the logic of its ruling would apply to depreciation, amortization, and other cost recovery deductions as well.

A quick word on the court's ruling with respect to the indemnities for Section 1603 grants. The opinion suggests the parties ended up agreeing that there were relevant factual questions (though not as to what the questions were). The plaintiffs' legal position is that an indemnity is not given separate value if it is commonly provided in the industry. Accordingly, the court denied the motion for summary judgment on the basis that there were material questions of fact.

What Does the Opinion Mean?

It's not entirely clear how to interpret the holding of the opinion. Here's what the court says: "The incremental cash consideration paid for the anticipated Section 1603 cash grants is not basis allocable to Class V tangible property … . The portion of the purchase price pertaining to consideration for the anticipated Section 1603 cash grants is grant-ineligible intangible property under Class VI (contract rights) or Class VI (goodwill or going concern value)." As a practical matter, it may be that the holding does not say much in the end because the waterfall method of allocating value under Section 1060 means you would allocate value to the grant only if there were value remaining after allocations to the tangible property in Class V. There is authority supporting the inclusion of both turnkey profit and developer profit in valuing the tangible property in projects. Accordingly, as valuation drove the result before the opinion, so will valuation drive the result after.

It may also be possible to limit the court's holding to Section 1603 grant cases and not extend it to tax credit cases. Although the Section 1603 grant eventually matures into an intangible asset (*i.e.,* a receivable) for tax purposes, tax credits do not. It is essential to the court's holding to find an intangible asset, and therefore, the holding may be limited to the Section 1603 grant.

Finally, the opinion concerns a motion for summary judgment, and is not a final disposition of the case. Assuming an interlocutory appeal is not permitted, the court's holding here will be among the legal questions to be raised on an appeal of the fully tried case.

Conclusion

The latest *Alta Wind* opinion is undoubtedly a disappointment to the industry, especially by comparison to the first trial court opinion in *Alta Wind*, which included cogent and persuasive analysis and correct (and yes, industry-favorable) conclusions on so many issues of interest to the industry. The only bright spot may be that because the analysis is both perplexing and inconsistent with common understanding of how tax benefits affect valuation of the underlying assets, the opinion may not have the influence an opinion that addresses these issues otherwise could have.

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