

IRS Issues Additional Guidance on “Begun Construction” Requirement for Wind Energy Credits

Latest guidance extends “continuity safe harbor” to four years and includes other taxpayer-friendly modifications and clarifications to existing guidance.

On May 5, 2016, the Internal Revenue Service (IRS) issued Notice 2016-31 (Notice) to provide additional guidance regarding the “begun construction” requirement for renewable energy facilities seeking to qualify for the production tax credit (PTC) under Section 45 of the Internal Revenue Code (Code) or the investment tax credit (ITC) in lieu of the PTC under Code Section 48. The PTC and ITC were extended in December 2015 under the Consolidated Appropriations Act, 2016 (Budget Act).¹ The Notice does not address the ITC extension for solar facilities, which the IRS intends to address in separate guidance.

Key highlights of the Notice include:

- Extension of the “continuity safe harbor” from two years to four years
- A prohibition on the use of different methods for satisfying the begun construction requirement in alternating years to extend the period for satisfying the continuity safe harbor
- A disaggregation rule to determine whether the continuity safe harbor has been satisfied by a renewable energy facility that is operated as part of a larger project
- Revisions to the non-exclusive list of construction disruptions that will not cause a renewable energy facility to fail the “continuous construction” or “continuous efforts” requirements
- Guidance on the application of the “5% safe harbor” to retrofitted renewable energy facilities

Wind Energy Tax Credits

Code Section 45 allows taxpayers to claim PTCs for each kilowatt hour of electricity produced by a qualifying wind energy facility and sold to unrelated persons during the 10-year period following the date the facility is placed in service. Under Code Section 48, taxpayers have the option of electing a one-time ITC (in lieu of the PTC) equal to a specified percentage of the cost of eligible property included in the facility.

Under the Budget Act extension, a wind facility is eligible for PTCs (or the ITC in lieu of PTCs) if construction of the facility begins before January 1, 2020 and the “continuity requirement” discussed below is satisfied. The amount of credits that taxpayers may claim with respect to qualifying wind facilities

is stepped down and phased out over time based on the construction start date of the facility. If construction begins:

- Before January 1, 2017, the facility is eligible for the full amount of PTCs or a 30% ITC
- During 2017, the facility is eligible for 80% PTCs or a 24% ITC
- During 2018, the facility is eligible for 60% PTCs or an 18% ITC
- During 2019, the facility is eligible for 40% PTCs or a 12% ITC
- After December 31, 2019, the facility is not eligible for any PTCs or ITC

Begun Construction Requirement

Under existing IRS guidance relating to prior PTC extensions, which continues to apply as modified by the Notice, the begun construction requirement can be satisfied by either:

- Starting physical work of a significant nature (the Physical Work Test) and thereafter maintaining a continuous program of construction
- Incurring 5% or more of the total eligible cost of the facility (the 5% Safe Harbor) and thereafter making continuous efforts to advance towards completion of the facility²

Continuity Requirement

Whether a project satisfies the continuity requirement of the Physical Work Test or 5% Safe Harbor generally is determined based on all facts and circumstances. Under a facts and circumstances approach, certain construction disruptions will not cause a facility to fail the continuity requirement. Prior IRS guidance provided a non-exclusive list of excusable disruptions, which includes licensing and permitting delays and financing delays not longer than six months. The Notice revises this list by (i) clarifying that permitting and licensing delays include permits and licenses issued by federal, state, local and tribal governments and agencies, (ii) adding interconnection-related delays and delays in the manufacture of custom components and (iii) removing the six-month limitation in the case of financing delays.

Modification of Continuity Safe Harbor

Prior IRS guidance also established a safe harbor (the Continuity Safe Harbor) under which the continuity requirement generally would be deemed satisfied if the facility was placed in service within two calendar years following the year in which construction began, regardless of the amount of physical work undertaken or costs incurred after satisfying either the Physical Work Test or the 5% Safe Harbor.

The Notice modifies the Continuity Safe Harbor by extending the safe harbor period to four years. Thus, a taxpayer satisfies the continuity requirement if the taxpayer places a facility in service within four calendar years after the calendar year in which construction began. For example, if physical work of a significant nature begins in 2016 for a facility, the continuity requirement will be satisfied if the facility is placed in service by December 31, 2020. This approach effectively allows up to almost five years to complete a project.

However, the Notice states that a taxpayer may not rely on the Physical Work Test and the 5% Safe Harbor in alternating years to satisfy the begun construction requirement. If a taxpayer begins physical

work of a significant nature in one year, the taxpayer cannot extend the Continuity Safe Harbor deadline by satisfying the 5% Safe Harbor in a subsequent calendar year. This approach may make financing a project more difficult if there is uncertainty regarding the calendar year in which the project will be placed in service. If a project does not satisfy the Continuity Safe Harbor, the project would need to satisfy the continuity requirement based on facts and circumstances, which may create uncertainty around the project's ultimate eligibility for credits. If it is uncertain whether a facility will be placed in service by the end of the Continuity Safe Harbor period, a developer may be incentivized to delay the beginning of construction to ensure that even a reduced amount of credits may be claimed. An IRS official has indicated that the IRS may revisit this rule.

An IRS official recently stated that the IRS may revisit this rule. An alternative approach could be a rebuttable presumption that, if a facility begins construction on or before December 31, 2019 and is placed in service by December 31, 2023, construction of the facility began in the latest year that would permit the facility to be eligible for credits, unless the taxpayer establishes — based on the facts and circumstances — that construction began in an earlier year and has been continuous since that earlier date. This alternative would better facilitate project financing because it would provide greater certainty that a facility satisfying the statutory outside placed-in-service date would be eligible for credits.

Disaggregation Rule

For purposes of the Physical Work Test or the 5% Safe Harbor, multiple facilities that are operated as part of a larger project may be aggregated and treated as a single facility.³ Thus, for example, a wind farm may satisfy the Physical Work Test if physical work of a significant nature begins before the statutory deadline for a portion of the turbines that are part of the wind farm. For purposes of the continuity requirement, the Notice establishes a helpful disaggregation rule under which satisfaction of the Continuity Safe Harbor is determined on a facility-by-facility basis. Thus, if some but not all turbines of a wind farm are placed in service by the end of the Continuity Safe Harbor period, the turbines that are timely placed in service will be deemed to satisfy the continuity requirement. The remaining turbines may satisfy the continuity requirement under the general facts and circumstances test.

Retrofitted Facilities

Under current guidance, a retrofitted facility may be treated as originally placed in service and therefore qualify for the PTC or the ITC if (i) the fair market value of new property added to the facility is at least 80% of the retrofitted facility's total fair market value and (ii) the facility otherwise satisfies the begun construction requirements described above. The Notice clarifies that for purposes of applying the 5% Safe Harbor, only expenditures related to the new portion of the facility are taken into account.

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Endnotes

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- ¹ For a detailed discussion of the renewable energy credits extension, see *Client Alert* Number 1907 [New Long-Term Extension of Wind and Solar Tax Credits Subject to Phase-out](#).
 - ² See Notice 2013-29, 2013-1 C.B. 1085; Notice 2013-60, 2013-2 C.B. 431; Notice 2014-46, 2014-2 C.B. 520; and Notice 2015-25, 2015-13 I.R.B. 814.
 - ³ For a detailed description of the factors considered in determining whether multiple facilities are operated as part of a larger project and thus treated as a single facility, see *Client Alert* Number 1501 [IRS Issues New Guidance for Renewable Energy Credits Requirement](#).