

INSIGHTS

IRS Updates Guidance on the Beginning of Construction Rule for Renewable Energy Production Tax Credits

May 13, 2016

On May 5, 2016, the Internal Revenue Service ("IRS") released Notice 2016-31 (the "Notice"). The Notice updates previous IRS guidance on satisfying the "beginning of construction" requirement for renewable energy facilities to qualify for the renewable energy production tax credits (the "PTC"), reflecting the extensions under the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act") of the "beginning of construction" date for renewable energy facilities to qualify for PTC. The Notice (i) extends and modifies the "continuity safe harbor" period in which a facility has to be placed in service, (ii) provides additional guidance regarding the application of the "continuity safe harbor" and the "significant physical work test", and (iii) clarifies the application of the "five percent safe harbor" to retrofitted renewable energy facilities. The Notice does not address the extension of the "beginning of construction" date for the investment tax credits (the "ITC") for solar energy facilities. The Treasury Department and the IRS anticipate issuing separate guidance addressing the extension of ITC for solar energy facilities.

Background

Prior to the PATH Act, a taxpayer was eligible to receive PTC under Section 45 of the Internal Revenue Code (the "Code") with respect to certain renewable energy facilities if construction of such facility began before January 1, 2015. The IRS has issued a series of notices to clarify what constitutes "beginning of construction" for a renewable energy facility. Notice 2013-29 provides that a taxpayer can establish the beginning of construction by satisfying either the "physical work test" or the "five percent safe harbor". Both tests require continuous progress towards completion once construction has begun.

- The "physical work test" is satisfied when physical work of a significant nature has begun before the "beginning of construction" date, and the construction has been continuous;
- The "five percent safe harbor" is satisfied when at least five percent of the total cost of the facility has been incurred before the "beginning of construction" date, and the construction has been continuous.

Subsequently, the IRS issued Notice 2013-60, which provides a safe harbor for satisfying the continuity requirement under either the "physical work test" or the "five percent safe harbor." Under Notice 2013-60, a facility would be considered to satisfy the continuity requirement if such facility was placed in service before January 1, 2016 (the "Continuity Safe Harbor"). Notice 2015-25 extends the Continuity Safe Harbor to cover any facility placed in service before

January 1, 2017. If a facility is not placed in service within the Continuity Safe Harbor, Notice 2013-29 provides that whether a facility satisfies the continuity requirement will be determined by the relevant facts and circumstances.

On December 18, 2015, the PATH Act extended the PTC (or the ITC in lieu of the PTC) for two years with respect to certain facilities the construction of which begins before January 1, 2017, and further extended the PTC (or the ITC in lieu of the PTC) for wind facilities the construction of which begins before January 1, 2020, with the PTC phasing out over four years. For a more detailed analysis of the PATH Act, please see our [January 8, 2016 Blog Post](#).

The Notice

Extension of the Continuity Safe Harbor

Consistent with the PATH Act extension of the credits generally, the Notice extends the Continuity Safe Harbor such that if a facility is placed in service on or before the last day of the fourth calendar year after the calendar year during which construction of the facility began, the facility will be considered to satisfy the Continuity Safe Harbor. For example, if construction begins on a facility on January 15, 2016, and the facility is placed in service by December 31, 2020, the facility will be considered to satisfy the Continuity Safe Harbor. However, the Notice further provides that a taxpayer may not rely on upon the "physical work test" and the "five percent safe harbor" in alternating calendar years to establish the "beginning of construction" or satisfy the "Continuity Safe Harbor". Thus if a taxpayer performs physical work of a significant nature on a facility in the first year, and then incurs five percent or more of the total cost of the facility in the second year, the Continuity Safe Harbor runs for four calendar years after the first year. Taxpayers are advised to carefully plan the project to achieve certainty as to when the facility must be placed in service to satisfy the Continuity Safe Harbor.

Aggregation and Disaggregation

The Notice provides that solely for purposes of determining the "beginning of construction" date, multiple facilities that are operated as part of a single project may be aggregated and treated as a single facility. Thus a wind farm with multiple wind turbines may satisfy the "physical work test" by performing physical work of a significant nature for a portion of the wind turbines that constitute the wind farm.

For purposes of determining when a facility is placed in service and whether a facility satisfies the Continuity Safe Harbor, the Notice provides that multiple facilities that are aggregated as described in the previous paragraph may be disaggregated and treated as multiple separate facilities. Thus in the example above, if some turbines in the wind farm are placed in service within the Continuity Safe Harbor but other turbines are not, the turbines that are placed in service before such deadline will be treated as having satisfied the Continuity Safe Harbor. The other turbines may satisfy the continuity requirement under the facts and circumstances determination provided in Notice 2013-29.

Retrofitted Facilities

Under Revenue Ruling 94-31, a retrofitted facility may qualify as originally placed in service, even though it contains some used property, if the fair market value of the used property is not more than 20 percent of the facility's total value, equal to the cost of the new property plus the value of the used property (the "80/20 Rule"). The Notice clarifies that (i) in the case of a single project comprised of multiple facilities, this 80/20 Rule is applied to each individual facility

comprising the project, and (ii) to establish the "beginning of construction" for purposes of determining eligibility for both PTC and ITC, the "five percent safe harbor" is applied only with respect to the cost of new property and thus only expenditures paid or incurred that relate to new construction should be taken into account for purposes of the "five percent safe harbor".

If you would like to discuss Notice 2016-31 and its impact, please contact one of the following members of Bracewell's tax team:

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