

# IRS Guidance Clarifies ‘Begun Construction’ Standard for Renewable Electricity Production Credit Property

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The Internal Revenue Service (IRS) has released welcome new guidance with respect to renewable electricity production and energy investment tax credits. A notice issued on May 5, 2016, reflects changes to the production tax credit (PTC) and investment tax credit (ITC) for certain renewable energy facilities made by the Protecting Americans From Tax Hikes (PATH) Act in December 2015. Qualified facilities include wind, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash, hydropower, and marine and hydrokinetic.

As described below in more detail, the new guidance clarifies, modifies and extends prior guidance related to (i) the date by which a facility must be placed in service in order to satisfy the continuous construction or continuous efforts safe harbor (collectively, the Continuity Requirement), (ii) the “physical work” test, and (iii) retrofitted facilities.

## Background

In general, a taxpayer can claim a PTC under Section 45 of the Internal Revenue Code (the Code) with respect to electricity produced at a qualified facility or, in lieu thereof, may elect to claim an ITC under Section 48 of the Code with respect to that facility, but in either case only if it has “begun construction” of the facility before certain specified dates.

The PATH Act extended the PTC for two years with respect to certain qualified facilities, the construction of which begins before January 1, 2017. It also extended the PTC for wind facilities, the construction of which begins before January 1, 2020, subject to a phase-out over the last three years.

Notice 2016-31 extends and modifies three earlier notices (Notices 2013-29, 2013-60 and 2014-46) to address whether construction of a facility has begun by the deadlines set forth in the PATH Act, thus determining eligibility for the PTC or ITC, and modifies the Continuity Requirement.

- Notice 2013-29 provides two methods to establish the beginning of construction for purposes of the PTC or ITC — a “physical work” test and a 5 percent safe harbor (*i.e.*, 5 percent of total costs).
- Notice 2013-60 clarifies the requirements outlined in Notice 2013-29, providing a safe harbor for meeting the Continuity Requirement, which was modified by Notice 2015-25 (the Continuity Safe Harbor).
- Notice 2014-46 clarifies that, with respect to a project composed of multiple facilities (*e.g.*, a multiple turbine wind farm), and provided the Continuity Requirement also is met, if a taxpayer has not fully satisfied the 5 percent safe harbor by the placed-in-service deadline but has paid or incurred at least 3 percent of the total cost of the project, the taxpayer may still claim the PTC or ITC on any number of individual facilities if the total aggregate cost of those individual facilities at the time the project is placed in service is not greater than 20 times the amount the taxpayer paid or incurred before the deadline.

## Modifications to the Continuity Requirement

Under the Continuity Safe Harbor as previously embodied in Notice 2013-60 and Notice 2015-25, a qualified facility — the construction of which began any time prior to January 1, 2015, and that was placed in service before January 1, 2017 — was considered to satisfy the Continuity Requirement. The notice provides that the Continuity Safe Harbor now runs for four calendar years from the year in which construction of the facility began. For example, if construction of a facility begins during 2016, so long as the facility is placed in service by December 31, 2020, the facility will be considered to satisfy the Continuity Safe Harbor.

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The notice further provides that the Continuity Safe Harbor begins upon the earlier of the first performance of significant physical work (the physical work test) or satisfaction of the 5 percent safe harbor, regardless of whether the other standard is met in a later year. Therefore, a taxpayer is precluded from relying on the physical work test in one year and the 5 percent safe harbor in a later year to satisfy the Continuity Requirement. This, coupled with the four-year Continuity Safe Harbor period described above, may be detrimental to certain taxpayers who started physical work or satisfied the 5 percent safe harbor in earlier years. For example, if a taxpayer started physical work on a facility in January 2012, the taxpayer must continue to rely on the physical work test and the facility must be placed in service by the end of this year in order to rely on the Continuity Safe Harbor.

Under prior guidance, for purposes of the beginning of construction requirement, multiple facilities that are operated as part of a single project (based on all the relevant facts and circumstances) are treated as a single facility. The notice states that this determination is made during the year in which the last of the multiple facilities is placed in service. The notice also clarifies that a single project comprised of multiple facilities may be disaggregated and treated as multiple separate facilities for purposes of determining whether any single facility satisfies the Continuity Safe Harbor. Those disaggregated facilities that are placed in service prior to the Continuity Safe Harbor deadline will be eligible for the Continuity Safe Harbor. The remaining disaggregated facilities, however, will need to rely on a facts-and-circumstances determination of whether the Continuity Requirement is met.

Finally, for purposes of the Continuity Requirement, the notice expands the list of excusable disruptions for facilities that do not qualify for the Continuity Safe Harbor. Accordingly, a project may now stop work without risking the loss of the PTC if, for example, the delay is due to (i) written requests of local or tribal governments regarding matters of public safety, (ii) interconnection-related delays, (iii) manufacturing of custom components, or (iv) financing issues (regardless of the duration of such financing issues).

## The Physical Work Test

The physical work test discussed above requires that a taxpayer begin physical work of a significant nature in order to establish the beginning of construction. The notice provides new examples showing how this test may be met for a variety of renewable energy facilities beyond just wind, such as hydropower, biomass and trash, and geothermal facilities.

The notice also expands on the list of preliminary activities that do not count as physical work of a significant nature. Notably, this nonexclusive list now includes (i) conducting geologic mapping and modeling, (ii) conducting geophysical, gravity, magnetic, seismic and resistivity surveys, and (iii) removing existing solar panels or any other components that will no longer be part of the facility.

## Retrofitted Facilities

A facility may qualify as originally placed in service even though it contains some used property, provided the fair market value of the used property is not more than 20 percent of the facility's total value (the cost of the new property plus the value of the used property) (the 80/20 rule). The notice clarifies that in the case of a retrofitted facility, the 5 percent safe harbor is applied only with respect to the cost of new property included in the facility.

## Solar Energy Facilities

Finally, the PATH Act extended the ITC for solar energy facilities the construction of which begins before January 1, 2022, subject to a three-stage step-down in the amount of the credit:

- For projects for which construction begins in 2020, the ITC will be reduced to 26 percent.
- For projects for which construction begins in 2021, the ITC will be reduced to 22 percent.
- For projects for which construction begins after 2021, the ITC will be reduced to 10 percent.

The notice states that the IRS anticipates issuing separate guidance addressing the PATH Act extension of the ITC for solar energy facilities.

## Conclusion

Overall, the notice provides considerable new guidance that will have a significant impact on the renewable energy industry. The guidance should provide greater certainty to developers and other investors hoping to begin and continue constructing projects within the extended periods allowed by the PATH Act without concern about the projects' eligibility for these tax credits.