

IRS Guidance on the Commencement of Construction Requirements for Tax Credits for Qualified Energy Facilities

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On April 15, 2013, the Internal Revenue Service released Notice 2013-29 (Notice), which established guidelines and a safe harbor to determine when construction has begun on a “qualified facility” for purposes of the renewable electricity production tax credit (PTC) under Section 45 of the Internal Revenue Code (Code) or the energy investment tax credit (ITC) under Section 48 of the Code. Qualified facilities include wind facilities, closed-loop biomass facilities, open-loop biomass facilities, geothermal facilities, landfill gas facilities, trash facilities, hydropower facilities, and marine and hydrokinetic facilities. In general, a taxpayer can claim PTCs with respect to electricity produced at a qualified facility or, in lieu thereof, may elect to claim an ITC with respect to that facility.

Pursuant to the American Taxpayer Relief Act of 2012, Congress modified the eligibility requirements applicable to qualified facilities with respect to which a taxpayer may claim PTCs or an ITC. Previously, a qualified facility was eligible if it was “placed in service” by a particular date. Now, a qualified facility is eligible if it has “begun construction” before January 1, 2014.

To establish the beginning of construction for purposes of the PTC or ITC, the Notice requires that a taxpayer either begin “physical work of a significant nature” or satisfy a 5 percent safe harbor. In general, the Notice mirrors the requirements in the Treasury’s Section 1603 Grant Program guidance, with the following notable exceptions:

- (1) **Definition of binding written contract.** Under both the grant guidance and the Notice, a contract is considered binding only if it does not limit damages to a specified amount (e.g., by use of a liquidated damages provision). However, the grant guidance contains a “*de minimis*” rule that allowed contractual provisions limiting damages to an amount equal to at least 5 percent of the total contract price. The Notice, on the other hand, does not include a similar rule, and thus effectively eliminates the ability to include any liquidated damages provisions in a binding written contract. This is a potentially onerous requirement, as EPC contracts, turbine supply contracts and similar agreements commonly contain liquidated damages provisions.
- (2) **Continuous construction and continuous efforts requirement.** The grant guidance contains a continuous construction requirement for purposes of the “physical work” test, but does not include a similar requirement for purposes of the 5 percent safe harbor. Unlike the grant guidance, the 5 percent safe harbor in the Notice requires that after incurring 5 percent or more of the total cost of a facility, the taxpayer must make continuous efforts to advance towards completion of the facility. The determination of whether a taxpayer maintains a continuous program of construction or makes continuous efforts to advance a facility to completion is generally based on the applicable facts and circumstances, taking into account several new factors contained in the Notice for determining whether certain disruptions are ignored for these purposes. The new continuous efforts requirement will make it more difficult to meet the safe harbor test and likely is intended to prevent the purchase of credit-eligible property for resale to another taxpayer.

In addition, the Notice expands on corollary rules in the grant guidance by including several factors for determining whether multiple facilities that are operated as part of a single project can be treated as a single facility.

Although the Notice provides welcome guidance for taxpayers intending to begin construction this year, the new rules may be more difficult to satisfy than hoped, given the changes from the grant guidance as noted above.