

IRS Guidance Clarifies Renewable Energy Tax Credit

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The Internal Revenue Service (IRS) has released welcome new guidance on renewable electricity production and energy investment tax credits. A notice issued on August 8, 2014, addresses when a facility or equipment maintains its qualification when transferred during the construction process, and how to determine whether construction has begun by a previously set January 1, 2014, deadline triggering eligibility for the production credit. Qualified facilities include wind, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash, hydropower, and marine and hydrokinetic. In general, a taxpayer can claim a production tax credit (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 investment tax credit (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 January 1, 2014.

Notice 2014-46 clarifies two earlier notices: 2013-29 and 2013-60. Notice 2013-29 provided 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 — and Notice 2013-60 clarified the requirements for taxpayers to make continuous progress towards completion once construction has begun and the ability of taxpayers to transfer a facility after construction has begun.

Transfers With Respect to a Qualified Facility

Notice 2014-46 clarifies several points regarding transfers of facilities or property, namely:

1. If a taxpayer acquires a fully or partially developed facility (*i.e.*, one that consists of more than just tangible personal property) from an unrelated party that had begun construction of the facility before January 1, 2014, the taxpayer may take into account, for purposes of the “begun construction” requirement, work performed or amounts paid or incurred by the unrelated party prior to January 1, 2014.
2. In contrast, if a taxpayer acquires from an unrelated party only tangible personal property (as opposed to a fully or partially developed facility), work performed or amounts paid or incurred by the unrelated party prior to January 1, 2014 will **not** count.
3. If a taxpayer begins construction of a facility prior to January 1, 2014, in one site and thereafter transfers the equipment and components to a different site, the work performed or amounts paid or incurred by the taxpayer prior to January 1, 2014, will still count.

The first two points are similar to rules in the Section 1603 Treasury Grant guidance and appear to be an attempt to prevent the trafficking of property that could otherwise form the basis for a qualifying facility, while permitting the transfer of projects in development (that is, projects that have permits or site access in place).

Safe Harbor

The notice also makes clear that if a taxpayer has not fully satisfied the 5 percent safe harbor by January 1, 2014, with respect to a project composed of multiple facilities (*e.g.*, a five turbine wind farm), but has paid or incurred at least 3 percent of the total cost of the facility, 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 January 1, 2014, provided that the “continuous efforts” test described in Notice 2013-29 also is met. This change will be helpful to certain taxpayers who have unexpected cost overruns on their projects or subsequently decide to expand their multi-facility projects.

The notice does not, however, go so far as to permit a taxpayer that has not satisfied the 5 percent safe harbor to claim credits with respect to any portion of a single facility that is not a single project composed of multiple individual facilities and that cannot be separated into individual facilities. One example of such a facility is an open-loop biomass facility, partly comprised of one boiler and one turbine generator that are functionally interdependent. If the developer of such a facility did not pay or incur 5 percent of the actual total cost of the facility, or begin physical work of a significant nature, before January 1, 2014, the developer would not be able to claim PTCs or the ITC with respect to the facility.

Overall, the notice resolves several open questions that remained after the IRS issued Notices 2013-29 and 2013-60. This welcome guidance should provide greater certainty to developers and other investors hoping to advance projects without concern about the projects’ eligibility for tax credits.