Client Alert

May 2016

IRS Issues Updated Guidance on Beginning of Construction Requirement Under Sections 45 and 48 of the Internal Revenue Code

The Internal Revenue Service has issued updated guidance on the "beginning of construction" requirement under Sections 45 and 48 of the Internal Revenue Code. The Protecting Americans from Tax Hikes Act of 2015 (Pub. L. No. 114-113, 129 Stat. 2242) (the "PATH Act"), which was signed into law on December 18, 2015, extended the "beginning of construction" deadline for certain renewable energy facilities.

On May 5, 2016, the Internal Revenue Service released Notice 2016-31, 2016-[__] I.R.B. [__] ("Notice 2016-31" or "the Notice"), which provides updated guidance on the beginning of construction requirement. The Notice extends and modifies the guidance previously provided in Notice 2013-29, 2013-1 C.B. 1085, Notice 2013-60, 2013-2 C.B. 431, Notice 2014-46, 2014-36 I.R.B. 520, and Notice 2015-25, 2015-13 I.R.B. 814 (collectively, the "prior notices") and provides additional guidance with respect to the continuous efforts and continuous construction safe harbor. The Notice also clarifies the prior notices with respect to the application of the 5 percent safe harbor to retrofitted facilities. The Notice indicates that separate guidance addressing the extension of the ITC for solar facilities will be released in the future. The Notice provides that the prior guidance continues to apply except as specifically changed.

Continuity Safe Harbor

The prior notices provide that once construction has begun under either the significant physical work test or the 5 percent safe harbor, that there must be continuous construction or continuous efforts (collectively, the "continuity requirements"). Under the prior notices, a facility would be deemed to satisfy the continuity requirements if such facility was placed in service by a certain date specified in the prior notices. In the prior notices, this date was typically specified as the end of the calendar year two calendar years from the year in which construction was required to have begun. Notice 2016-31 discontinues the practice of fixing specified dates by which a facility must be placed in service to satisfy the continuity requirements and instead provides that a facility must be placed in service during a calendar year that is no more than four calendar years from the calendar year in which the facility began construction (the "Continuity Safe Harbor"). Notice 2016-31 provides an example, stating that a facility on which construction begins on January 15, 2016, will be deemed to satisfy the Continuity Safe Harbor if that facility is placed in service by December 31, 2020.

Notice 2016-31 also clarifies certain issues with respect to the Continuity Safe Harbor. First, it specifies that a taxpayer may not delay the begun construction date of a facility for purposes of the Continuity Safe Harbor by relying upon the Physical Work Test and the 5 percent Safe Harbor in alternating calendar years. The Notice states, for example, that if a taxpayer performs physical work in 2015 and then incurs 5 percent or more of the total cost of the facility in 2016, the Continuity Safe Harbor will be applied beginning in 2015, not 2016. In other words, you must determine application of the Continuity Safe Harbor based on the first year in which construction began. You cannot move that date forward by doing additional work or incurring additional costs in a subsequent year.

If the Continuity Safe Harbor is not met, then a taxpayer can still satisfy the continuity requirements by demonstrating such efforts through facts and circumstances. With regard to the facts and circumstances test, the Notice expands the nonexclusive list of excusable construction disruptions that will not be considered as indicating that a taxpayer has failed to maintain continuous efforts or continuous construction. Of particular interest to sponsors, developers, and equity investors, the expanded list: clarifies the types of excusable licensing and permitting delays; adds interconnection-related delays (including those related to the construction of transmission lines and upgrades); adds delays in the manufacture of custom components; and removes the six-month time limit on financing delays.

Physical Work Test

First, Notice 2016-31 provides an expanded nonexclusive list of examples of what activities constitute physical work of a significant nature for various renewable energy facilities. The Notice includes not only the example for wind facilities contained in the prior notices, but also provides examples of physical work of a significant nature for hydropower, biomass and trash facilities, and geothermal facilities. Additionally, the Notice reinforces that physical work of a significant nature does not include preliminary activities, as specified in Notice 2013-29. The Notice goes on to provide a nonexhaustive list of activities that constitute "preliminary activities"—including planning and designing, securing financing, and obtaining permits and licenses.

Single Project

Notice 2016-31 clarifies certain issues relating to the determination of whether multiple facilities are operated as part of a single project and should be treated as a single facility for purposes of determining when a facility has begun construction. The Notice specifies that the timing for the single project determination must be made in the calendar year during which the last of the multiple facilities are placed in service. Additionally, the Notice provides that multiple facilities operated as part of a single project and treated as a single facility may be disaggregated. Disaggregated facilities that are placed in service during the Continuity Safe Harbor period will satisfy the Continuity Safe Harbor, and the remaining disaggregated facilities may still satisfy the continuity requirements under a facts and circumstances determination. The disaggregation rule may be applied to facilities that rely on the Physical Work Test or the 5 percent safe harbor.

5 Percent Safe Harbor for Retrofitted Facilities

As stated in the prior notices, a facility may qualify as originally placed in service, despite containing used property if such used property comprises no more than 20 percent of the total value of the facility. This rule is generally referred to as the 80/20 rule. The 80/20 rule applies separately to each facility, i.e., each separate wind turbine. Notice 2016-31 provides that, in circumstances where new property is used to retrofit or repower an existing facility, only costs relating to the new construction should be taken into account for purposes of satisfying the 5 percent safe harbor. The costs incurred for the new work are then compared to the total costs for all of the new work to determine whether the 5 percent safe harbor is satisfied. No part of the value of the old property is taken into account in applying the 5 percent safe harbor test.

The new guidance provides needed comfort and clarity in evaluating which projects will satisfy the beginning of construction requirement as extended by the PATH Act.

Click the following link for a copy of Notice 2016-31. If you have any questions regarding the Notice, please contact us.

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