

Chapman Client Alert

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Current Issues Relevant to Our Clients

Renewable Energy Update — IRS Updates PTC and ITC Eligibility Requirements Following Tax Extensions

In December 2015, Congress passed the Protecting Americans from Tax Hikes Act of 2015 (the “*Path Act*”), which extended certain federal renewable energy tax credits for projects that began construction prior to the dates set forth in the Path Act. In response to that extension, the IRS has issued additional guidance with respect to a renewable energy facility’s eligibility to receive these tax credits. The following alert provides a summary of the IRS’ recent guidance.

Background

Under the American Taxpayer Relief Act of 2012, qualified renewable energy generation facilities that began construction prior to January 1, 2014 were eligible to receive the renewable electricity production tax credit (“*PTC*”) under section 45 of the Internal Revenue Code (the “*Code*”) or, in lieu thereof, the energy investment tax credit (“*ITC*”) under section 48 of the Code. Since that time, Congress extended twice the date by which a renewable energy generation facility must begin construction. In addition, the IRS has issued several notices to clarify a taxpayer’s eligibility with respect to the PTC and/or ITC. The following provides a summary of the key events related to the beginning of construction analysis:

- 1. April 2013 Guidance** — The IRS issued preliminary guidance (IRS Notice 2013-29) setting forth two alternative tests for establishing when construction of a qualifying facility “began”: (1) the commencement of physical work of a significant nature (the “*Physical Work Test*”) and (2) the satisfaction of a 5% safe harbor (the “*Five Percent Safe Harbor*”). The IRS stated that, in order to satisfy the Physical Work Test, a taxpayer would need to maintain a “continuous program” of construction with respect to its facility and, in order to satisfy the Five Percent Safe Harbor, the taxpayer would need to maintain “continuous efforts” to advance the completion of the facility (collectively, the “*Continuity Requirement*”). In each case, the IRS indicated that it would make its determination based on the relevant facts and circumstances.
- 2. October 2013 Guidance** — The IRS updated its April 2013 Guidance (IRS Notice 2013-60) to clarify that the Continuity Requirement would be deemed satisfied if the facility was placed in service before January 1, 2016 (the “*Continuity Safe Harbor*”). For facilities placed in service after January 1, 2016, the IRS stated that it would continue to
- make its determination based on the relevant facts and circumstances. The IRS also clarified certain other aspects related to master contracts and the transfer of a facility after the beginning of construction.
- 3. August 2014 Guidance** — The IRS issued a notice (IRS Notice 2014-46) to clarify that “there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the Physical Work Test.” In addition, the IRS clarified its prior notices regarding transfers after the beginning of construction and the Five Percent Safe Harbor’s application to projects that are comprised of multiple facilities. See Chapman Client Alert, dated August 19, 2014 (available [here](#)), for additional detail regarding the August 2014 Guidance.
- 4. December 2014 Extension** — Congress extended the date by which qualified renewable energy generation facilities must begin construction to January 1, 2015.
- 5. March 2015 Guidance** — The IRS issued a notice (IRS Notice 2015-25) extending the Continuity Safe Harbor by one year to January 1, 2017.
- 6. December 2015 Extension** — Congress extended the PTC for wind facilities that began construction prior to January 1, 2020 and for certain other facilities that began construction prior to January 1, 2017. This extension was coupled with an incremental phase out of the PTC over four years. In addition, Congress extended the ITC for solar facilities that began construction before January 1, 2022, coupled with a phase down from 30% to 10%.
- 7. May 2016 Guidance** — The IRS has now issued an additional notice (IRS Notice 2016-31) to further clarify the PTC in response to the December 2015 Extension. The IRS has stated that a separate notice will be issued with respect to the extension of the ITC for solar projects.

May 2016 Guidance – IRS Notice 2016-31

Continuity Safe Harbor

In the May 2016 Guidance, the IRS extended the Continuity Safe Harbor. Under the new guidance, if a facility is in service during a calendar year that is no more than four calendar years after the calendar year in which construction of the facility began, the facility will satisfy the Continuity Safe Harbor.

Continuity Requirement

In addition to extending the Continuity Safe Harbor, the IRS:

1. Clarified that a taxpayer cannot switch back and forth between the Physical Work Test and the Five Percent Safe Harbor in alternating calendar years to satisfy the beginning of construction requirement or the Continuity Requirement.
2. Expanded the non-exclusive list of excusable disruptions with respect to the Continuity Requirement. The list now includes severe weather conditions, natural disasters, delays in obtaining permits from, or delays at the written request of, federal, state, local or Indian tribal governments, interconnection-related delays, delays in the manufacturing of custom components, labor stoppages, the inability to obtain specialized equipment of limited availability, the presence of endangered species, financing delays and supply shortages.

Physical Work Test

As part of the May 2016 Guidance, the IRS reaffirmed that there is no fixed minimum amount of work or monetary or percentage thresholds required to satisfy the Physical Work Test. To that end, the IRS provided various illustrative examples as to what satisfies the Physical Work Test. The IRS also clarified that preliminary activities cannot be used to satisfy the Physical Work Test and provided a non-exclusive list of what constitutes a preliminary activity.

In addition, the IRS provided additional guidance on the eligibility of the PTC to multiple facilities that are treated as a single project. Specifically, the IRS stated that multiple facilities that are treated as part of the same project will be treated as a single project for purposes of determining whether construction of a facility has begun. Whether multiple facilities will be treated as a single project will depend on the facts and circumstances and will be determined in the calendar year in which the last of the multiple facilities is placed in service. However, for purposes of determining whether the Continuity Safe Harbor has been satisfied, the multiple facilities may be disaggregated and those facilities that are placed in service before the Continuity Safe Harbor deadline will be eligible for the Continuity Safe Harbor and the eligibility of the other facilities will be determined based on the facts and circumstances. The IRS noted that these rules apply to both the Physical Work Test and the Five Percent Safe Harbor.

Retrofitted Facilities

Lastly, the May 2016 Guidance clarified that, in cases where a retrofitted facility qualifies for the PTC, the Five Percent Safe Harbor is applied only with respect to the cost of the new property used to retrofit the existing facility. Thus, only expenditures related to “new construction” may be considered when determining the Five Percent Safe Harbor.

For More Information

If you would like further information concerning the matters discussed in this alert, please contact Melanie Gnazzo, Bruce Bedwell, or any other member of Chapman’s Project Finance Group:

Melanie J. Gnazzo
San Francisco
415.278.9020
mgnazzo@chapman.com

Bruce A. Bedwell
Chicago
312.845.3755
bedwell@chapman.com

Chapman and Cutler LLP

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