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IRS Issues New Guidance On The Beginning Of Construction Safe Harbor For Renewable Energy Projects: Foley & Lardner

The IRS recently issued Notice 2017-4 (the “Notice”) which makes two important changes to its “beginning of construction” rules for taxpayers seeking to take advantage of the section 45 renewable electricity production tax credit (PTC) for wind and other renewable energy facilities including geothermal, biomass, landfill gas and certain hydropower and marine hydrokinetic energy projects. Under prior IRS guidance, including Notice 2016-31 discussed in our blog post here, taxpayers have two ways to establish that they started construction. They can either show that they began physical construction of a significant nature (the “Physical Work Test”), or incurred at least 5% of the total cost of the eligible facility (the “5% Safe Harbor”). However, once construction has begun or cost have been paid or incurred, the IRS requires taxpayers to make continuous progress towards completion to satisfy both the Physical Work Test and the 5% Safe Harbor (“Continuous Construction Requirement”). Taxpayers are deemed to satisfy the Continuous Construction Test provided they began construction on the facility prior to January 1, 2015, and place it in service prior to January 1, 2017 (the “Continuity Safe Harbor”).

The Notice now permits taxpayers to fall within the Continuity Safe Harbor provided that they place the facility in service by the later of (1) a calendar year that is no more than four calendar years after the construction of the facility began or (2) December 31, 2018. This provides additional time for developers that have satisfied the Physical Work Test or 5% Safe Harbor to complete construction and place the facility in service without having to demonstrate that the Continuous Construction Requirement was satisfied. For example, if construction begins on January 15, 2013, and the facility is placed in service by December 31, 2018, the facility will meet the Continuity Safe Harbor.

The Notice also provides that the prohibition on taxpayers using both the Physical Work Test and 5% Safe Harbor methods in alternating years to push forward the facility’s placed in service deadline does not apply to taxpayers that began construction on a project under either test prior to June 6, 2016. (The date that Notice 2016-31, which established this rule, was published.) Accordingly, taxpayers that began construction before this deadline can show that they have made continuous progress towards construction by relying on the Physical Work Test in one year and then relying on the 5% Safe Harbor the following year after they have paid enough costs to meet the 5% threshold. This is helpful because taxpayers acquiring projects may not have been satisfied with the manner in which the prior developer demonstrated the commencement of construction. The new rule permits them to “requalify” the project under a different method.

Last, the Notice provides guidance for developers using the 5% Safe Harbor for repowering and retrofitting existing projects. In order to take advantage of the tax credit, the facility must be “new” as determined by the 80/20 rule, which means that the cost of new parts must be four times the value of the used parts. The Notice clarifies that for purposes of satisfying the 5% Safe Harbor, the cost of the new property includes all costs properly included in depreciable basis, meaning that

indirect costs that are allocated to the new property's depreciable basis should count towards the 5% Safe Harbor.

Last Updated: December 28 2016

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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