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IRS Clarifies Guidance on Construction of Energy Facilities.

The IRS has clarified (Notice 2014-46) prior guidance (Notice 2013-29, Notice 2013-60) on the construction of qualified energy facilities, addressing the application of the physical work test and the ability to transfer a facility after construction has begun. The notice also modifies the application of the 5 percent safe harbor.

Under the physical work test, a taxpayer may establish the beginning of construction by beginning physical work of a significant nature as described in Notice 2013-29 or by meeting the safe harbor in that notice. Under the safe harbor, a taxpayer must show that after the facility is placed in service, 5 percent or more of its total cost was paid or incurred before January 1, 2014. Both the physical work test and the safe harbor require that a taxpayer make continuous progress toward completion once construction has begun.

Notice 2013-60 in part clarifies that the transfer of a facility after construction has begun will not necessarily prevent a facility from qualifying for the renewable electricity production tax credit (PTC) under section 45 or the energy investment tax credit (ITC) under section 48. The notice also explains how to satisfy either the continuous construction test or the continuous efforts test for purposes of establishing continuous progress.

Notice 2014-46 clarifies the application of the physical work test and the effect that some transfers of a facility after construction has begun will have on a taxpayer's ability to qualify for the PTC or the ITC. Specifically, a fully or partially developed facility may be transferred without losing its qualification under the physical work test or the safe harbor for purposes of the PTC or the ITC. Addressing equipment relocations, the notice explains that the taxpayer may begin construction in 2013, intending to develop it at one site, but instead transfer equipment to a different site, complete its development, and place it in service. In this case, the work performed or amount paid or incurred before January 1, 2014, may be taken into account for purposes of determining whether the facility satisfies the physical work test or the safe harbor. For transfers consisting solely of tangible personal property to an unrelated transferee, any work performed or amount paid or incurred by the transferor for that property will not count toward the transferee's satisfaction of the physical work test or the safe harbor.

Notice 2014-46 modifies the application of the safe harbor for some facilities for which a taxpayer paid or incurred less than 5 percent, but at least 3 percent, of the total cost of the facility before January 1, 2014. The notice discusses single projects composed of multiple facilities, stating the PTC or ITC may be claimed on some but not all the individual facilities. The guidance also states that a taxpayer won't satisfy the safe harbor for any part of a single facility that is not a single project composed of multiple individual facilities and that cannot be separated into individual facilities if the amount the taxpayer paid or incurred before January 1, 2014, for the total cost is less than 5 percent of the total cost of the facility at the time it is placed in service. Examples illustrate these modifications and clarifications.

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Clarification and Modification of Notice 2013-29 and Notice 2013-60

Part III — Administrative, Procedural, and Miscellaneous

SECTION 1. PURPOSE

On January 2, 2013, the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313(ATRA), modified the definition of certain qualified facilities under section 45(d) of the Internal Revenue Code (the Code) by replacing the placed in service requirement with a beginning of construction requirement. Accordingly, a taxpayer will be eligible to receive the renewable electricity production tax credit (PTC) under section 45, or the energy investment tax credit (ITC) under section 48 in lieu of the PTC, with respect to such a facility if construction of such facility began before January 1, 2014.

Notice 2013-29, 2013-1 C.B. 1085, provides two methods to determine when construction has begun on a qualified facility: (i) a "physical work" test and (ii) a five percent safe harbor. Notice 2013-60, 2013-2 C.B. 431, clarifies Notice 2013-29 regarding (i) the determination of whether a taxpayer satisfies either the continuous construction requirement or the continuous efforts requirement of those methods with respect to a facility, (ii) the applicability of the "master contract" provision, and (iii) the ability to transfer a facility after construction has begun. This notice further clarifies Notices 2013-29 and 2013-60 regarding (i) how to satisfy the physical work test and (ii) the effect of various types of transfers with respect to a facility after construction has begun. In addition, this notice modifies the application of the five percent safe harbor.

The guidance provided in this notice applies the rules of sections 45 and 48 as in effect on January 1, 2014. The Internal Revenue Service (Service) will not issue private letter rulings to taxpayers regarding the application of this notice or the application of the beginning of construction requirement under sections 45(d) and 48(a)(5) as provided in Notice 2013-29 and Notice 2013-60.

SECTION 2. BACKGROUND

A taxpayer may establish the beginning of construction by beginning physical work of a significant nature as described in section 4 of Notice 2013-29 (Physical Work Test). Alternatively, a taxpayer may establish the beginning of construction by meeting the safe harbor provided in section 5 of Notice 2013-29 (Safe Harbor). A taxpayer can satisfy the Safe Harbor with respect to a facility by demonstrating, after the facility is placed in service, that five percent or more of the total cost of the facility was paid or incurred before January 1, 2014. Both methods require that a taxpayer make continuous progress towards completion once construction has begun (as set forth in section 4.06 (Continuous Construction Test) and section 5.02 (Continuous Efforts Test) of Notice 2013-29, respectively).

In response to a significant number of questions received after the publication of Notice 2013-29, the Treasury Department and the Service issued Notice 2013-60, which in part clarifies that the transfer of a facility after construction has begun will not necessarily prevent a facility from qualifying for the PTC or the ITC. Additionally, section 3.02 of Notice 2013-60 provides a method for taxpayers to satisfy either the Continuous Construction Test or the Continuous Efforts Test. If a taxpayer places a facility in service before January 1, 2016, the facility will be considered to satisfy the Continuous Construction Test (for purposes of satisfying the Physical Work Test) or the Continuous Efforts Test (for purposes of satisfying the Safe Harbor), regardless of the amount of physical work performed or the amount of costs paid or incurred with respect to the facility between December 31, 2013, and January 1, 2016.

After the publication of Notice 2013-60, the Treasury Department and the Service received requests for further clarification regarding how to satisfy the Physical Work Test as well as questions regarding the effect of various types of transfers with respect to a facility after construction has begun. This notice clarifies the application of the Physical Work Test and the effect that certain transfers with respect to a facility after construction has begun will have on a taxpayer's ability to qualify for the PTC or the ITC. In addition, this notice modifies the application of the Safe Harbor for certain facilities with respect to which a taxpayer paid or incurred less than five percent, but at least three percent, of the total cost of the facility before January 1, 2014.

SECTION 3. PHYSICAL WORK TEST

The Physical Work Test requires that a taxpayer begin physical work of a significant nature (as defined in section 4.02 of Notice 2013-29) prior to January 1, 2014. This test focuses on the nature of the work performed, not the amount or cost. Notice 2013-29 describes several activities that constitute physical work of a significant nature. These activities are merely examples and not an exclusive list of the activities that will satisfy the Physical Work Test. For example, section 4.02 of Notice 2013-29 provides:

[I]n the case of a facility for the production of electricity from a wind turbine, on-site physical work of a significant nature begins with the beginning of the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation.

Section 4.05(1) of Notice 2013-29 provides:

[P]hysical work on a custom-designed transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission is physical work of a significant nature with respect to the facility because power conditioning equipment is an integral part of the activity performed by the facility.

Section 4.05(2) of Notice 2013-29 provides:

Roads that are integral to the facility are integral to the activity performed by the facility; these include onsite roads that are used for moving materials to be processed (for example, biomass) and roads for equipment to operate and maintain the qualified facility. Starting construction on these roads constitutes physical work of a significant nature with respect to the facility.

Beginning work on any one of the activities described above will constitute physical work of a significant nature.

Section 4.04(3) of Notice 2013-29 provides an example in which X, a developer of a 50 turbine wind farm, is found to satisfy the beginning of construction requirement in part based on the stated fact that, in 2013, for 10 of the 50 turbines, X excavates the site for the foundations of the wind turbines and pours concrete for the supporting pads. This example illustrates the "single project" concept set forth in section 4.04(2) of Notice 2013-29 and is not intended to indicate that there is a 20% threshold or minimum amount of work required to satisfy the Physical Work Test. Assuming the work performed is of a significant nature, there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the Physical Work Test.

As provided in section 4.01 of Notice 2013-29 the Service will closely scrutinize a facility, and may determine that construction has not begun on a facility before January 1, 2014, if a taxpayer does not maintain a continuous program of construction as determined under section 4.06 of Notice 2013-29 and section 3.02 of Notice 2013-60.

SECTION 4. TRANSFERS WITH RESPECT TO A FACILITY

.01 In general. Certain of the definitions of a qualified facility provided in section 45(d) require that the construction of the facility begin before January 1, 2014. There is no statutory requirement that the taxpayer that places the facility in service also be the taxpayer that begins construction of the facility. See Notice 2013-60, section 5.01. Moreover, section 48(a)(5)(D) defines "qualified property" (which may be eligible for the ITC in lieu of the PTC) as certain property that is "constructed, reconstructed, erected, or acquired by the taxpayer." (Emphasis added.) Thus, except as provided in section 4.03 of this notice, a fully or partially developed facility may be transferred without losing its qualification under the Physical Work Test or the Safe Harbor for purposes of the PTC or the ITC. For example, a taxpayer may acquire a facility (that consists of more than just tangible personal property) from an unrelated developer that had begun construction of the facility prior to January 1, 2014, and thereafter the taxpayer may complete the development of that facility and place it in service. The work performed or amount paid or incurred prior to January 1, 2014, by the unrelated transferor developer may be taken into account for purposes of determining whether the facility satisfies the Physical Work Test or Safe Harbor.

.02 Relocation of equipment by a taxpayer. A taxpayer also may begin construction of a facility in 2013 with the intent to develop the facility at a certain site, but thereafter transfer equipment and other components of the facility to a different site, complete its development, and place it in service. The work performed or amount paid or incurred prior to January 1, 2014, by such a taxpayer may be taken into account for purposes of determining whether the facility satisfies the Physical Work Test or the Safe Harbor.

.03 Transfers of equipment between unrelated parties. In the case of a transfer consisting solely of tangible personal property (including contractual rights to such property under a binding written contract) to a transferee not related (defined for these purposes by reference to section 197(f)(9)(C)) to the transferor, any work performed or amount paid or incurred by the transferor with respect to such property so transferred will not be taken into account with respect to the transferee for purposes of the Physical Work Test or the Safe Harbor.

Example. Developer D intends to develop and operate Facility K at a location to be determined. Prior to January 1, 2014, Developer D pays or incurs $60,000 to have tangible personal property integral to Facility K manufactured off-site pursuant to a binding written contract. Thereafter Developer D incurs no further development costs and engages in no further development activity with respect to Facility K. In January 2014, Developer D sells the tangible personal property to Developer E, a party unrelated to Developer D. Developer E is developing and intends to operate Facility L, a facility located on a parcel of land owned by Developer E. Developer E incorporates the tangible personal property acquired from Developer D into Facility L. In October 2015, Developer E places Facility L in service on the parcel of land. The total cost of Facility L is $1,000,000.

Amounts paid or incurred by Developer D prior to January 1, 2014, for the tangible personal property will not be taken into account for purposes of satisfying the Safe Harbor with respect to Facility L. However, if without regard to these components, Developer E has otherwise satisfied the Physical Work Test or the Safe Harbor with respect to Facility L, Developer E will be eligible to claim the PTC with respect to electricity generated by Facility L and sold to an unrelated party. In such a case, Developer E may alternatively elect to claim the ITC in lieu of the PTC.

SECTION 5. SAFE HARBOR

.01 Single project. If the amount a taxpayer paid or incurred before January 1, 2014, with respect to the total cost of a facility that is a single project comprised of multiple facilities (as described in

section 4.04(2) of Notice 2013-29) is less than five percent of the total cost of the facility at the time the facility is placed in service, the Safe Harbor is not fully satisfied. However, if a taxpayer paid or incurred at least three percent of the total cost of such a facility before January 1, 2014, the Safe Harbor may be satisfied and the PTC or ITC may be claimed with respect to some, but not all, of the individual facilities (as described in section 4.04(1) of Notice 2013-29) comprising the project. In this situation, a taxpayer may claim the PTC or ITC on any number of individual facilities as long as the total aggregate cost of those individual facilities at the time the project is placed in service is not greater than twenty times the amount the taxpayer paid or incurred before January 1, 2014. The Continuous Efforts Test of section 5.02 of Notice 2013-29 must also be met to qualify for the Safe Harbor.

.02 Single facility. If the amount a taxpayer actually paid or incurred before January 1, 2014, with respect to the total cost of a single facility that is not a single project comprised of multiple individual facilities (as described in section 4.04(2) of Notice 2013-29), and that cannot be separated into individual facilities, is less than five percent of the total cost of the facility at the time the facility is placed in service, then the taxpayer will not satisfy the Safe Harbor with respect to any portion of the facility.

.03 Examples — (a) Example 1. Developer incurs $30,000 in costs prior to January 1, 2014, to construct Project M, a five-turbine wind farm, that will be operated as a single project (as described in section 4.04(2) of Notice 2013-29). In October 2015, Developer places Project M in service. The total cost of Project M is $800,000, with each turbine costing $160,000. Although Developer did not pay or incur five percent of the total cost of Project M before January 1, 2014, Developer did pay or incur at least three percent of the total cost of Project M before January 1, 2014. In addition, because Developer placed Project M in service before January 1, 2016, Developer is deemed to satisfy the Continuous Efforts Test pursuant to section 3.02 of Notice 2013-60. Accordingly, Developer will be treated as satisfying the Safe Harbor with respect to three of the turbines of Project M, as their total aggregate cost of $480,000 is not greater than twenty times the $30,000 in costs incurred by Developer prior to January 1, 2014. Thus, Developer may claim the PTC on electricity produced from three of the turbines of Project M or the ITC based on $480,000, the cost of three of the turbines of Project M.

(b) Example 2. Developer incurs $25,000 in costs prior to January 1, 2014, to construct Facility N, an open-loop biomass facility, partly comprised of one boiler and one turbine generator that are functionally interdependent. In October 2015, Developer places Facility N in service. The total cost of Facility N is $600,000. Because Developer did not pay or incur five percent of the actual total cost of Facility N before January 1, 2014, and because the boiler and turbine generator are integral parts of a single facility that is not a single project comprised of multiple facilities (as described in section 4.04(2) of Notice 2013-29), Developer will not satisfy the Safe Harbor. However, if physical work of a significant nature began (within the meaning of section 4.01 of Notice 2013-29, as clarified by section 3 of this notice) before January 1, 2014, Developer may be able to claim the PTC or the ITC with respect to Facility N.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Notice 2013-29, 2013-1 C.B. 1085, and Notice 2013-60, 2013-2 C.B. 431, are clarified and modified.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Bernardini on (202) 317-6853 (not a toll-free call).

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