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Orrick: IRS Issues Additional Guidance on "Start Of Construction" Requirement for Renewable Energy Tax Credits.

On August 8, 2014, the IRS released Notice 2014-46, which provides additional guidance on the "start of construction" requirements for the investment tax credit (ITC) and production tax credit (PTC). As discussed below, Notice 2014-46 provides additional guidance on satisfying the physical work test, the effect of transfers of a facility after construction has begun, and also modifies the five percent safe harbor.

As a result of the American Taxpayer Relief Act of 2012, to claim ITC or PTC with respect to a renewable energy project, construction must have begun before January 1, 2014. The IRS has previously issued guidance on the start of construction requirements in Notices 2013-29 and 2013-60. Notice 2013-29 provides two methods by which to satisfy the start of construction requirement. One method is to perform physical work of a significant nature before January 1, 2014. The other method is to pay or incur five percent or more of the total cost of a facility before January 1, 2014 (the five percent safe harbor). In addition, work on the project must be "continuous" in order for either method to be met (by meeting a "continuous program of construction" test or a "continuous efforts" test, as applicable).

In Notice 2013-60, the IRS clarified Notice 2013-29 by (i) providing that the "continuous" work tests would be deemed met if a facility is placed in service before January 1, 2016, (ii) clarifying that a taxpayer could look through a master contract in certain situations for purposes of both the physical work test and the five percent safe harbor, and (iii) clarifying that the start of construction requirement can be met with respect to a facility even if the facility is later transferred to a different taxpayer who then places the facility in service.

Notice 2014-46 clarifies that there is no fixed minimum threshold amount of work that must be performed (or cost that must be paid or incurred) to satisfy the physical work test. Notice 2013-29 provided an example in which a taxpayer met the physical work test with respect to a 50 turbine wind farm by excavating foundations for 10 wind turbines (that is, 20% of the total turbines). Notice 2014-46 states that this example is not intended to indicate that there is a 20% minimum threshold amount of work that must be performed to satisfy the physical work test.

Notice 2014-46 also provides additional guidance with respect to transfers of a facility after construction has begun. The Notice provides that if a taxpayer begins construction of a facility in 2013 with the intent to develop a facility at a certain site, but thereafter transfers equipment and other components to a different site, the work performed or costs paid or incurred with respect to the first site will be taken into account in determining whether the start of construction requirement is met with respect to the facility placed in service at the second site. However, the Notice also provides that, in the case of a transfer consisting solely of tangible personal property between two unrelated parties, work performed or costs paid or incurred by the transferor will not be taken into account with respect to the transferee in determining whether the start of construction requirement is met. However, if the transferee is related to the transferor, the transferee can "piggyback" on the

costs paid or work performed by the transferor. A transferor will be related to a transferee partnership if it has a more than 20% capital or profits interest in the transferee.

Finally, Notice 2014-46 modifies the five percent safe harbor by providing an exception for single projects that are comprised of multiple facilities which do not meet the overall five percent requirement. If a single project is comprised of multiple facilities (for example, a wind farm comprised of multiple wind turbines), and a taxpayer has paid or incurred at least three percent of the total cost of the facility before January 1, 2014, then the taxpayer will be treated as satisfying the five percent safe harbor with respect to some of the individual facilities so long as the total aggregate cost of those individual facilities is not greater than twenty times the amount the taxpayer paid or incurred before January 1, 2014. The following example illustrates this rule: A taxpayer incurs $30,000 in costs prior to January 1, 2014 with respect to a five turbine wind farm. The total cost of the wind farm is $800,000 and each turbine costs $160,000. The five percent test is not met with respect to the entire wind farm because the costs incurred prior to January 1, 2014 ($30,000) are less than five percent of the total cost of the wind farm ($40,000). However, under the modified safe harbor rule in Notice 2014-46, the taxpayer is treated as satisfying the five percent safe harbor with respect to three of the turbines. The total cost of three turbines ($480,000) is less than twenty times the amount of costs incurred prior to January 1, 2014 ($600,000).

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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.