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McGuireWoods: IRS Extends Safe Harbor for Completion of PTC-Qualifying Facilities to Jan. 1, 2017.

Yesterday, March 11, 2015, the Internal Revenue Service issued Notice 2015-25, which extends by one year certain tests taxpayers can use to establish that a qualifying renewable energy facility is eligible for the production tax credit (PTC) or, alternatively, the investment tax credit (ITC).

Notice 2015-15 updates prior IRS guidance in response to a change made by the Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, 128 Stat. 4010 (2014 Extenders Bill). The date by which construction must have begun for a qualifying renewable energy facility to be eligible for the PTC or ITC was extended from “before January 1, 2014,” to “before January 1, 2015.” Under prior guidance, a taxpayer could establish the beginning of construction by either starting physical work of a significant nature (Physical Work Test) or paying or incurring 5 percent or more of the total cost of the facility (Safe Harbor). Under either method, the taxpayer was required to make continuous progress toward completion once construction began. Prior guidance further provided that if a facility was placed in service before January 1, 2016, the facility would 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).

Under Notice 2015-25, taxpayers now have until January 1, 2017, to complete construction of pre-2015 facilities. The IRS extension of the Continuous Construction and Continuous Efforts tests does not apply to Section 1603 Grants, which have independent requirements to complete construction by a certain date and, in many instances, dates that have already passed.

The PTC provides certain renewable-energy-electricity-producing projects (including those involving wind, geothermal sources, biomass and municipal solid waste, such as biomethane) with a tax credit of approximately \$0.023/kWh for energy generated and sold to a third party. The tax credit can be claimed for the 10-year period following commercial operation of the project and often is used in tax equity transactions to offset some of the capital costs of constructing qualifying renewable energy facilities. Alternatively, taxpayers can elect to take the ITC in lieu of the PTC for certain qualifying facilities. The ITC provides a one-time tax credit equal to 30 percent of the tax basis of the qualifying facility.

One-Year Extension of the PTC Drives IRS Extension of the Safe Harbor

The notice provides a one-year extension of the current Continuous Construction Test and the Continuous Efforts Test provided in IRS Notice 2013-60. The PTC previously expired on January 1, 2014, but was extended late last year. Under the 2014 Extenders Bill, a taxpayer would be eligible to claim the PTC, or the ITC in lieu of the PTC, if construction began on the qualifying renewable energy facility before January 1, 2015. As now revised, the Continuous Construction and Continuous Efforts tests are consistent with this one-year extension.

Prior IRS Guidance for Satisfying “Begin Construction” Requirement

As noted above, a taxpayer can satisfy the “begin construction” requirement of Code Section 45(d) if

it meets either the Physical Work Test or the Expenditure Safe Harbor before January 1, 2015. In both cases, the taxpayer must make continuous progress toward completion once construction has begun. In an effort to provide clarity and certainty to the Continuous Construction and Continuous Efforts tests, the IRS issued Notice 2013-60. The earlier, 2013 notice provided a useful safe harbor by deeming the continuous construction or efforts requirement to be satisfied if the facility was placed in service before January 1, 2016. Notice 2015-25 extends this date to January 1, 2017.

At the time the IRS provided the initial safe harbor for satisfying the continuous construction or efforts requirement, the PTC was set to expire on December 31, 2013. This gave taxpayers two years after the scheduled PTC expiration date to place facilities into service and still satisfy the Continuous Construction or Continuous Effort Test without having to show that they were making continuous progress toward completion once construction began. As explained below, the extended date of January 1, 2017, is important to current projects.

2014 PTC Extension Created Construction Pressure and Questions

The passage of the 2014 Extenders Bill placed construction pressure on 2014 projects since they could rely on the safe harbor for satisfying the continuous construction or efforts requirement only if their projects were actually completed before the end of 2015. Tax practitioners also began fielding questions from developers concerned that projects satisfying the begin-construction requirement in 2014 would likely spill into 2016, given construction schedules, financing considerations and other commercial matters. Many developers had valid concerns about how to meet the Continuous Construction or Continuous Efforts tests without a safe harbor, and how to satisfy the conservative nature of tax equity investors or project lenders.

Safe Harbor Extension Relieves Construction Pressure for 2014 PTC Projects

Fortunately, the IRS has now issued guidance allowing facilities that are completed before January 1, 2017, to satisfy the Continuous Construction and Continuous Efforts tests if construction of the facility began before January 1, 2015. This extension of the safe harbor comes at a valuable time, when 2014 projects still have sufficient opportunities to secure construction contracts, financing and tax equity investments. Additionally, the safe harbor extension creates IRS precedent to extend the safe harbor in lockstep with any future extensions of the PTC. Clearly, the IRS intends to allow a two-year window after the expiration of the PTC for taxpayers to complete construction of a renewable energy facility without having to show continuous progress toward completion once construction of a qualifying facility has begun.

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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.