

LEGAL UPDATES

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Service  
Tax Credits

## IRS Clarifies Production Tax Credit Qualification for Renewable and Alternative Energy Facilities

With developers in the renewable energy industry racing to complete energy projects across the country by January 1, 2016, the Internal Revenue Service (IRS) has published additional guidance to reduce uncertainty regarding the ability of certain projects to qualify for production tax credits (PTCs).

On August 8, 2014, the IRS issued Notice 2014-46 to provide additional guidance regarding the continuous construction tests and other matters pertaining to PTC qualification. Notice 2014-46 reconfirms and expands on the guidance provided in previously issued Notices.

### Background

The American Taxpayer Relief Act of 2012 (ATRA) was enacted on January 2, 2013. ATRA had the effect of altering the mechanism for identifying qualified facilities under section 45(d) of the Internal Revenue Code by replacing the previous requirement that such facilities be *placed in service* by January 1, 2013, with a requirement that construction on those facilities begin prior to January 1, 2014. This alteration spurred further activity in the renewable energy industry by extending the opportunity to claim PTCs, but the new test also created uncertainty. In order to rely on this change in the law, developers needed guidance regarding standards that would be applied in determining, under the new law, when construction of a renewable energy project actually had begun.

To assist developers, the IRS published guidance regarding the beginning of construction for certain assets to qualify for PTCs in Notice 2013-29 and Notice 2013-60 (collectively, the Prior Notices). The Prior Notices established two methods by which a developer could verify that construction had begun by

the statutory deadline. The first such method, the “Physical Work Test,” provides that construction begins when physical work of a significant nature has started with respect to a project and thereafter progresses pursuant to a continuous program of construction (the “Continuous Construction Test”). The second method, the “Safe Harbor,” stipulates that construction will have commenced if: (a) a developer incurs expenses in an amount equal to five percent (5%) or more of the total cost of a project; and (b) the developer makes continuous efforts to complete construction of the project (the “Continuous Efforts Test”).

Even with the guidance provided by the Prior Notices, questions still remained, especially with respect to the interpretation of the phrases “continuous program of construction” (with respect to the Physical Work Test) and “continuous efforts to complete construction” (with respect to the Safe Harbor). Notice 2014-46 provides further guidance to address these questions.

### **Continuous Construction**

The IRS significantly reduced uncertainty surrounding a developer’s ability to satisfy the Continuous Construction Test or the Continuous Efforts Test, providing in Notice 2014-46 that both tests will be satisfied so long as a facility is placed in service prior to January 1, 2016.

This guidance paves the way for projects that initially had satisfied either the Physical Work Test or the Safe Harbor but, for one reason or another, had stopped construction. Previously, only a cessation of construction that was beyond the developer’s control could justify a failure of either the Continuous Construction Test or the Continuous Efforts Test. Now, circumstances ranging from a developer’s marshalling of its resources to difficulties in obtaining financing will not restrict a developer’s ability to qualify for PTCs, so long as the project is placed in service prior to January 1, 2016. This relaxation of the continuous construction standards should provide a benefit for developers of projects that had stalled during the first seven months of 2014.

### **Satisfying the Physical Work Test**

Notice 2014-46 also clarifies that the Physical Work Test “focuses on the nature of the work performed, not the amount or cost.” This statement alleviates concerns that physical work may be of a significant nature yet not encompass a significant enough portion of the project to pass muster. According to the IRS, “[a]ssuming 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.” Consequently, even physical work on a single transformer or road prior to January 1, 2014 should be sufficient as long as the project is placed in service by January 1, 2016.

### **Preserving PTC Qualification on Transfer**

Finally, Notice 2014-46 re-confirms that if a project that satisfied the beginning of construction test (either through the Physical Work Test or the Safe Harbor) is transferred to an unrelated taxpayer, the transferee can rely upon the transferor's satisfaction of the beginning of construction requirement. This, combined with the easing of the continuous construction standards and the Physical Work Test, should allow developers whose projects stalled to revive and market those projects to other developers with the resources to quickly restart construction.

The IRS also indicated that if a developer relocates equipment to another site or project, that developer still may utilize such relocated equipment to satisfy the Physical Work Test or Safe Harbor test. Notably, however, a transfer *solely* of items of tangible personal property (including contractual rights to such property) to an unrelated taxpayer cannot be utilized by such unrelated taxpayer to satisfy either the Physical Work Test or Safe Harbor test. The tangible personal property must instead be transferred as part of a project in order for an unrelated taxpayer to be able to take those items into account for satisfaction of the beginning of construction requirement. This aspect of Notice 2014-46, however, confirms a developer's ability to allocate qualified equipment in a manner that maximizes the attractiveness of one or more projects within the developer's portfolio, including for purposes of project marketability.

### **What This Means To You**

While Notice 2014-46 does not resolve all questions arising out of the Prior Notices, and while there is no relief for projects that met the Physical Work Test or Safe Harbor but will not be completed before January 1, 2016, developers who are able to move quickly now have a clearer path forward for a number of projects that previously appeared quite risky.

### **Contact Us**

For additional information regarding how these guidelines impact your business and potential investments, please contact John Crossley, leader of Husch Blackwell's Wind Energy practice, at 816.983.8339.