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Client Alert

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Renewable Energy Update – IRS Provides Additional Clarification on PTC / ITC Eligibility Requirements

Background

Under the American Taxpayer Relief Act of 2012 (the "***Act***"), qualified renewable energy generation facilities that began construction prior to January 1, 2014 are eligible to receive the renewable electricity production tax credit ("***PTC"***) under section 45 of the Internal Revenue Code (the "***Code***") or, in lieu thereof, the energy investment tax credit ("***ITC***") under section 48 of the Code. Since its passage, the IRS has issued the following notices to clarify a taxpayer's eligibility with respect to the PTC and/or ITC:

1. In April 2013, the IRS issued preliminary guidance (IRS Notice 2013-29, referred to herein as the "***April 2013 Guidance***") setting forth two alternative tests for establishing when construction of a qualifying facility "began": (1) the commencement of physical work of a significant nature (the "***Physical Work Test***") and (2) the satisfaction of a 5% safe harbor (the "***Safe Harbor***"). The IRS stated that, in order to satisfy the Physical Work Test, a taxpayer would need to maintain a "continuous program" of construction with respect to its facility and, in order to satisfy the Safe Harbor, the taxpayer would need to maintain "continuous efforts" to advance the completion of the facility. In each case, the IRS indicated that it would make its determination based on the relevant facts and circumstances. Effectively, this meant that the IRS' determination would not be made until after the facility had been completed and well after the taxpayer had committed substantial resources.

2. To help bring certainty to taxpayers that their facilities would qualify for the PTC / ITC before they dedicated their resources, the IRS updated its April 2013 Guidance in September 2013 (IRS Notice 2013-60, referred to herein as the "***September 2013 Guidance***") to clarify the following:

   - The "continuous program" and "continuous efforts" requirements would be deemed satisfied if the facility was placed in service before January 1, 2016. For facilities placed in service after January 1, 2016, the IRS would continue to make its determination based on the relevant facts and circumstances. Consequently, so long as a facility satisfied either the Physical Work Test or the Safe Harbor before January 1, 2014; AND was placed in service before January 1, 2016, the facility would qualify for the PTC / ITC.

   - The Master Contract provision in the Physical Work Test also applied to the Safe Harbor. This meant that, for purposes of determining whether either the Physical Work Test or the Safe Harbor was satisfied, the IRS would take into account components that were (1) manufactured, constructed or produced for a taxpayer by another person under a binding written contract (a "***Master Contract***"), and (2) then assigned (through another binding written contract) to an affiliated special purpose vehicle that owns the facility in which such components will be used.

   - If a facility satisfies either the Physical Work Test or the Safe Harbor, the taxpayer that owns the facility during the 10-year period following the date the facility is placed in service may claim the PTC even if such taxpayer did not own the facility at the time construction began. Alternatively, the taxpayer that owns the facility on the date it is placed in service may claim the ITC even if such taxpayer did not own the facility at the time construction began (limited to such taxpayer's basis in qualified property).

3. On August 8, 2014, the IRS issued an additional notice (IRS Notice 2014-46, referred to herein as the "***August 2014 Guidance***") to further clarify the Act and, in part, modify its prior clarifications.

August 2014 Guidance – IRS Notice 2014-46

Physical Work Test

Under the Physical Work Test, physical work of a significant nature must have began prior to January 1, 2014. As part of the April 2013 Guidance, the IRS provided certain examples of what constitutes physical

work of a significant nature, but did not provide a complete list of such activities. Moreover, the IRS did not expressly tie the requirement to a specific level of cost and/or to any minimum threshold.

Following the September 2013 Guidance, the IRS received a number of requests asking it to clarify whether its examples were intended to imply that a taxpayer must complete a certain level of work or expend a certain amount of money in order to satisfy the Physical Work Test. In the August 2014 Guidance, the IRS has clarified that "there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the Physical Work Test." The IRS reiterated, however, that the work performed must be of a significant nature.

Transfers

Under the Act, there is no requirement that the taxpayer that places a facility in service must be the same taxpayer that began construction of the facility. In the August 2014 Guidance, the IRS clarified that:

- Except as provided in the following bullet, a fully or partially developed facility that is transferred after the start of construction does not lose its qualifications under the Physical Work Test or the Safe Harbor. This is true even if the facility is acquired from an unrelated developer. Therefore, the amount of work performed or costs paid or incurred by a transferring developer (included an unrelated developer) prior to January 1, 2014 may be taken into account by the acquirer of such facility when determining whether the two tests have been satisfied.

- Notwithstanding the foregoing bullet, if a transfer consists solely of tangible personal property (including contract rights) to an unrelated party, any work performed or costs paid or incurred with respect to such property may not be taken into account when determining whether the two tests have been satisfied. Note that the August 2014 Guidance is silent as to such transfers to related parties.

- If a taxpayer begins construction of a facility intending to locate the facility on a specific site, the taxpayer may relocate the facility to another site after it begins construction without losing eligibility for the PTC/ ITC. In other words, any work performed or costs paid or incurred prior to January 1, 2014 may be taken into account when determining whether the two tests have been satisfied even if the taxpayer elects to transfer the equipment and other components of the facility to a different site.

Safe Harbor

When determining whether the Safe Harbor has been satisfied with respect to a facility (e.g., a wind farm) that is a singe project comprised of multiple facilities (e.g., multiple wind turbines), the Safe Harbor is not satisfied for such facility (e.g., the wind farm) if the amount paid or incurred by a taxpayer prior to January 1, 2014 related to the total cost of the facility (e.g., the wind farm) is less than five percent of the total cost of the facility at the time the facility is placed in service.

In the August 2014 Guidance, the IRS modified this general rule to provide that, notwithstanding the foregoing, if a taxpayer paid or incurred less than five percent but at least three percent of the total cost of the facility (e.g., the wind farm) 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 comprising the project (e.g., the individual wind turbines).

In other words, even if the entire project does not qualify for the Safe Harbor, some of the individual facilities may still qualify. This is only true, however, if the total aggregate cost of those individual facilities (e.g., the wind turbines) at the time the project is placed in service is not greater than twenty times the amount the taxpayer paid or incurred prior to January 1, 2014. The continuous efforts test must also be satisfied.

If the project cannot be separated into multiple facilities (e.g., a biomass facility comprised of a boiler and a turbine generator), then this rule does not apply.

For More Information

For more information, please contact Bruce Bedwell (312.845.3755) or your primary Chapman attorney, or visit us online at chapman.com.