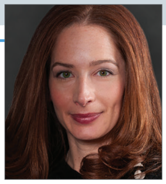


Leah Karlov, Tax Partner • Michael Goon, Tax Associate
Milbank, Tweed, Hadley & McCoy LLP

IRS Notice 2016-31: Beginning construction under the PATH Act

On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act),[1] which extended the production tax credit (PTC) under section 45 of the Internal Revenue Code (the Code) for wind facilities that begin construction before January 1, 2020. The PATH Act also extended the PTC for other renewable energy facilities, such as biomass, geothermal, and hydrokinetic.

However, after 2016, the PTC for wind facilities is subject to a phaseout. For example, if construction begins:

- In 2017, the PTC will undergo a 20% reduction.
- In 2018, the PTC will undergo a 40% reduction.
- In 2019, the PTC will undergo a 60% reduction.

On May 5, 2016, the Internal Revenue Service (IRS) released Notice 2016-31 (Notice),[2] clarifying the circumstances under which a taxpayer has officially begun construction under the PATH Act.[3]

Background

On April 15, 2013, the IRS published Notice 2013-29,[4] providing guidance on what it means to "begin construction" under the American Taxpayer Relief Act of 2012 (ATRA), the original legislation that introduced the "begun construction" requirement.[5]

Notice 2013-29 provided two alternative ways to demonstrate that construction had begun before the ATRA deadline of January 1, 2014.[6]

1. By beginning physical work of a significant nature before January 1, 2014 (the "physical work test"), or
2. By paying or incurring at least 5% of the total cost of the eligible property before January 1, 2014 (the "5% safe harbor").[7] Among other requirements, the physical work test requires that the taxpayer maintain a continuous program of construction after it has begun at a site. The 5% safe harbor requires that the taxpayer maintain continuous efforts to advance toward completion of a project after 5% of the total costs have been paid or incurred for the project.

On September 20, 2013, the IRS published Notice 2013-60[8], which among other things provided a safe harbor in applying the continuous efforts and continuous construction requirements (collectively known as the "continuity safe harbor").[9]

More recently, to address the PATH Act's extension of the PTC, the IRS also released the Notice, which is intended to:

1. Further extend and modify the continuity safe harbor.
2. Provide additional guidance regarding the application of the continuity safe harbor and the physical work test.
3. Clarify the application of the 5% safe harbor to retrofitted renewable energy facilities.

Unless otherwise specified, the Notice also maintains that the guidance provided in Notice 2013-29, Notice 2013-60, Notice 2014-4610, and Notice 2015-25 continues to apply.

Continuity safe harbor

Under the Notice, the continuity safe harbor will be satisfied as long as a taxpayer places a facility in service during a calendar year that is within four calendar years of the year during which construction began on a project.[11] For example, if construction of a wind facility begins on January 15, 2016, and the facility is placed in service on or before December 31, 2020, then it will meet the continuity safe harbor.

The Notice specifies that a taxpayer may not rely upon the physical work test and 5% safe harbor in alternating calendar years. This means that if a taxpayer performs physical work of a significant nature on a facility in 2015, and then pays or incurs 5% or more of the total cost of that facility in 2016, the continuity safe harbor will apply beginning in 2015 and not in 2016. Moreover, the facility must be placed in service no later than December 31, 2019 to satisfy the continuity safe harbor.

It is critical that taxpayers are mindful of the activities conducted at or with respect to a facility (including expenses incurred) because the clock can begin ticking for purposes of the continuity safe harbor, regardless of a taxpayer's intention.

The Notice also revises and expands the non-exclusive list of permitted construction disruptions.

Additions include:

1. Interconnection-related delays (e.g., those relating to the completion of construction on a new transmission line or necessary transmission upgrades to resolve grid congestion issues that may be associated with a project's planned interconnection).
2. Delays in the manufacture of custom components.[12] In terms of permissible financing delays, the Notice has removed the qualification that financing delays be less than six months.[13]

Physical work test

In the Notice, the IRS reiterates that the physical work test focuses on the nature of the work performed and not the amount of work or the cost. The Notice maintains that if the work performed is of a significant nature, there is no fixed minimum amount of work or monetary, or percentage threshold, required under the physical work test.[14]

In the case of wind facilities, excavation for the foundation, setting of anchor bolts into the ground, and pouring of concrete pads of the foundation are some examples of physical work of a significant nature.

A facility

As is consistent with prior guidance, the Notice defines a "facility" to include all components of property that are functionally interdependent (i.e., the placing in service of each component is dependent upon the placing in service of each of the other components in order to generate electricity).[15]

Multiple facilities operated as part of a single project are treated as a single facility whether a taxpayer is relying on the physical work test or the 5% safe harbor.[16] The determination of whether multiple facilities are operated as a single project, and therefore treated as a single facility, must be made in the calendar year during which the last of the multiple facilities is placed in service.[17]

Whether a developer is relying upon the physical work test or the 5% safe harbor, multiple facilities that are treated as a single facility for determining whether construction of a facility has begun may be disaggregated and treated as multiple separate facilities for purposes of determining whether a facility satisfies the continuity safe harbor.[18] The disaggregated facilities that are placed in service by the continuity safe harbor deadline will be eligible for the continuity safe harbor, and those that are not may satisfy the continuity requirements under a facts and circumstances determination.

Retrofitted facilities

The Notice provides that a facility comprised in part of used property may qualify as originally placed in service, provided that the fair market value of the used property is not more than 20% of the facility's total value (known as the 80/20 rule).[19]

In the case of a single project comprised of multiple facilities, the 80/20 rule is applied to each individual facility. Furthermore, with respect to the 5% safe harbor, only expenditures paid or incurred that relate to new construction are taken into account.[20]

For further reading

1Pub. L. No. 114-113, Div. Q, 129 Stat. 2242 (2015).

2 Notice 2016-31 (May 5, 2016).

3 The PATH Act also extended the investment tax credit (ITC) for solar energy facilities for construction that begins before January 1, 2022. However, the Notice does not provide guidance for the extension of the ITC for solar energy facilities, but a separate related guidance is expected to follow.

4 Notice 2013-29 (Apr. 15, 2013).

5 Pub. L. No. 112-240, 126 Stat. 2313 (2013).

6 On December 19, 2014, the Tax Increase Prevention Act of 2014 (TIPA) extended by one year to January 1, 2015 — the date by which construction of a qualified facility must begin. Pub. L. No. 113-295, 128 Stat. 4021 (2014).

7 Notice 2013-29, § 3.

8 Notice 2013-60 (Sept. 20, 2013).

9 Under Notice 2013-60, pursuant to ATRA, a taxpayer was deemed to satisfy the continuity safe harbor if a project was placed in service before January 1, 2016. Pursuant to TIPA, the IRS released Notice 2015-25 (Mar. 11, 2015), extending the continuity safe harbor in Notice 2013-60 by one year to projects placed in service before January 1, 2017.

10 On August 8, 2014, the IRS released Notice 2014-46, clarifying and modifying Notices 2013-29 and 2013-60.

11 Notice 2016-31, § 3.

12 Notice 2016-31, § 4.02(2)(e) and (f).

13 Notice 2016-31, § 4.02(2)(j).

14 Notice 2016-31, § 5.01.

15 Notice 2016-31, § 5.04(1).

16 Notice 2016-31, § 5.04(2).

17 Notice 2016-31, § 5.04(3).

18 Notice 2016-31, § 5.04(4).

19 Notice 2016-31, § 6.01.

20 Notice 2016-31, § 6.02.