



IRS Releases New Guidance Regarding Taxpayer Eligibility for Renewable Energy Tax Credits Under Code Sections 45 and 48

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On August 8, 2014, in response to a number of questions regarding taxpayers' eligibility for renewable electricity production tax credits ("PTCs") under Section 45 of the Internal Revenue Code of 1986, as amended (the "Code"), and Code Section 48 energy investment tax credits ("ITCs"), the IRS issued Notice 2014-46 to clarify the beginning of construction requirements for a facility and the applicability of the beginning of construction test with respect to facilities that are transferred after construction begins.

Under Code Sections 45 and 48, as well as under Notices 2013-29 and 2013-60, the IRS provided that a taxpayer would be eligible to qualify for ITCs and PTCs if, among other things, construction on the facility began before January 1, 2014. Notice 2013-29 stated that the beginning of construction requirement could be satisfied either (i) by making a significant beginning of physical work (the "Physical Work Test") or (ii) after the facility has been placed into service, by showing that at least five percent of the total cost of the facility had been incurred or paid before January 1, 2014 (the "Safe Harbor Test"). The relevant Code and notice provisions also required that for purposes of satisfying either the Physical Work Test or the Safe Harbor Test, the taxpayer must also have made continuous progress toward completing the project after construction began. Notice 2013-60 provided that this "continuous progress" requirement could be satisfied merely by placing the facility into service before January 1, 2016. In that notice, the IRS and the Treasury Department also indicated that an owner or developer's transfer of a facility after construction begins would not necessarily bar the facility from qualifying for an ITC or a PTC.

With respect to the Safe Harbor Test, Notice 2014-46 lowers the five percent safe harbor to three percent in certain circumstances. In addition, this notice clarifies the manner in which both (i) the Physical Work Test (described above) and (ii) the transfer of a facility after the beginning of construction will affect a taxpayer's eligibility for ITCs and PTCs.

Physical Work Test Requirements

Notice 2014-46 provides that the Physical Work Test described above was intended to focus entirely upon the type of work that must have been undertaken before January 1, 2014, rather than upon the cost or amount of work that must have been undertaken. As long as the work that has been undertaken on a facility is "significant" and is part of a continuous program of construction, then the

facility will satisfy the Physical Work Test and will be deemed to have begun construction, regardless of the actual amount of work that has been completed or the money that has been spent on the project. In order for work performed on a facility to qualify as a continuous program of construction, the taxpayer must make continuous efforts toward completing construction of that facility, as determined by the relevant facts and circumstances. Notice 2013-29 lists certain financial, permitting, contractual, and physical work developments that will satisfy this requirement. In addition to these general guidelines, Notice 2014-46 also clarifies that the list that the IRS provided in Notice 2013-29 serves only as a series of examples of situations in which a facility would satisfy the Physical Work Test.

Safe Harbor Test Requirements

As an alternative to satisfying the Physical Work Test, a taxpayer may satisfy the “beginning of construction” requirement by complying with the Safe Harbor Test. While the threshold requirement for the payment or incurrence of five percent of the total cost of the facility prior to January 1, 2014 for a single, individual facility that cannot be separated into multiple facilities remains a five percent threshold with the issuance of Notice 2014-46, this notice lowers the threshold of the Safe Harbor Test for certain other facilities. Specifically, for a single project that is comprised of multiple facilities, the IRS will now deem a taxpayer to have at least partially satisfied the Safe Harbor Test if the cost that the taxpayer has paid or incurred prior to January 1, 2014 comprises at least three percent of the total cost of the facility. In this situation, the IRS will now deem the Safe Harbor Test to be partially satisfied, and the ITC or PTC may be claimed for some, but not all, of the facilities that form the overall project. A taxpayer whose facility is structured in the manner described immediately above will satisfy the Safe Harbor Test for any of the individual component facilities for which the total aggregate cost of such individual component facility is not greater than 20 times the amount that the taxpayer paid or incurred before January 1, 2014.

Effect of Transferring a Facility

While some confusion has existed regarding whether and under which circumstances a taxpayer who purchases a facility for which construction has already begun but which has not yet been placed in service may be eligible for ITCs or PTCs, Notice 2014-46 clarifies that, with a few exceptions, the fact that a facility that is already partially or fully constructed is transferred to another taxpayer does not affect the ability to satisfy the “beginning of construction” requirement for purposes of obtaining PTCs or ITCs under Code Sections 45 and 48. However, Notice 2014-46 specifies that in the case of a transfer of solely tangible personal property, without any subsequent development or construction, to a transferee who is not related to the transferor, any amount that the transferor pays or incurs prior to the transfer will not be taken into account for purposes of satisfying the “beginning of construction” requirement.

In addition, Notice 2014-46 provides that a taxpayer’s relocation of the equipment or components of a facility to a different site after the taxpayer has begun construction on the facility does not affect the taxpayer’s ability to satisfy the “beginning of construction” requirement, as all work performed at the original site will be taken into account for purposes of both the Physical Work Test and the Safe Harbor Test.

Conclusion

By issuing Notice 2014-46, the IRS has sought to clarify, and in certain circumstances modify, the situations in which a taxpayer may satisfy or qualify for the “beginning of construction” requirements

for purposes of qualifying for ITCs or PTCs under Code sections 45 and 48. Please call one of our energy tax credit experts if you would like to discuss further.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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