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Tax Group Client Alert:

IRS Notice 2014-46: IRS Addresses What it Means to Have Begun Construction Prior to January 1, 2014

On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (the "Act")[1] which, among other things, replaced the requirement that certain production tax credit ("PTC")[2] and investment tax credit ("ITC")[3] eligible facilities (not including solar facilities) be placed in service by the applicable credit termination date with a requirement that construction of such facilities begin before January 1, 2014.[4]

On April 15, 2013, the Internal Revenue Service (the "IRS") published Notice 2013-29, providing guidance on what it means to "begin construction" under the Act.[5] (A copy of Notice 2013-29 can be found here.) Notice 2013-29 provided two alternative ways to demonstrate that construction had begun: (1) by beginning physical work of a significant nature before January 1, 2014 (the "physical work test") and (2) by paying or incurring at least 5% of the total cost of the eligible property before January 1, 2014 (the "5% safe harbor").[6] Among other requirements, the physical work test requires that the taxpayer maintain a continuous program of construction and the 5% safe harbor requires that the taxpayer maintain continuous efforts to advance towards completion of the project, in each case after construction has begun (or, in the case of the 5% safe harbor, after 5% of the total costs have been paid or incurred). Notice 2013-29 provided very little guidance on what activities would satisfy either of these requirements, and also left unanswered how the new rules would apply to transferees. In addition, although Notice 2013-29 specified that physical work under a "master supply contract" entered into by a related party could satisfy the physical work test, it didn't specify the costs incurred under such a contract could be used in applying the 5% safe harbor.

On September 20, 2013, the IRS published Notice 2013-60 clarifying certain aspects of the guidance provided in Notice 2013-29.[7] (A copy of Notice 2013-60 can be found here.) Specifically, Notice 2013-60: (1) provided a "safe harbor" in applying the "continuous efforts" and "continuous construction" requirements; (2) addressed the ap-

[1] Pub. L. No. 112-240, 126 Stat. 231 (2013).

[2] I.R.C. § 45.

[3] I.R.C. § 48.

[4] In addition to wind facilities, this new "begins construction" standard applies to closed and open-loop bio-mass facilities, geothermal facilities, landfill gas facilities, trash facilities, qualified hydropower facilities and qualified marine and hydrokinetic renewable energy facilities. The ITC for solar facilities remains available for systems placed in service prior to January 1, 2017.

[5] I.R.S. Notice 2013-29 (Apr. 15, 2013).

[6] Notice 2013-29, § 3.

[7] Notice 2013-60 (Sept. 20, 2013).

plicability of costs incurred under a master supply contract to the 5% safe harbor, and (3) clarified that a facility remained eligible even if transferred after construction had begun. Notwithstanding these clarifications, Notice 2013-60 left unanswered several questions, some of which have been addressed in the newly published guidance described below. (Our prior Client Alerts on the Act, Notice 2013-29 and Notice 2013-60 can be found here, here, and here.)

On August 8, 2014, the IRS released Notice 2014-46 (the "Notice"), clarifying and modifying Notices 2013-29 and 2013-60.[8] (A copy of Notice 2014-46 can be found here.) The Notice provides additional clarification regarding (i) satisfaction of the physical work test and (ii) the effect of certain transfers with respect to a facility after construction has begun. The Notice also modifies a particular aspect of the 5% safe harbor in what seems to be a concession aimed at one or more particular utility-scale projects.

PHYSICAL WORK TEST

The physical work test requires that a taxpayer began physical work of a significant nature (as defined in section 4.02 of Notice 2013-29) prior to January 1, 2014.[9] The Notice clarifies that the focus of the physical work test is the nature of the work performed and not the cost of the work.[10] It was emphasized that there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the physical work test. The examples provided in Notices 2013-29 and 2013-60 were intended to be illustrative only.

The Notice also confirms that the continuous construction and continuous efforts requirements provided in Section 4.06 and Section 5.02 of Notice 2013-29, as clarified and modified by Section 3 of Notice 2013-60, continue to apply.[11]

TRANSFERS OF FACILITIES AND TRANSFERS OF EQUIPMENT

Transfers of Facilities

The Notice provides that, subject to certain exceptions, a fully or partially developed facility may be transferred without losing its qualification under the physical work test or the 5% safe harbor. The Notice specifically refers to transfers to unrelated parties and draws a distinction between a fully or partially developed project (i.e., a facility that consists of more than just tangible property), and equipment (i.e., tangible personal property and the contractual rights to such property under a binding written contract).[12] Work performed or amounts incurred by the transferor of a fully or partially developed facility may be taken into account by the unrelated transferee for purpose of determining whether the physical work test or 5% safe harbor are satisfied.[13] However,

[8] I.R.S. Notice 2014-46 (Aug. 8, 2014).

[9] Notice 2014-46, § 3.

[10] Notice 2014-46, § 3.

[11] Notice 2014-46, § 3.

[12] Notice 2014-46, § 4.01.

[13] Notice 2014-46, § 4.01.

such work or amounts incurred may not be taken into account by the unrelated transferee if only equipment (and contractual rights thereto) are transferred.[14]

The Notice addresses only transfers to unrelated parties and is silent as to transfers between related parties. Although the Notice does not specifically address transfers between related parties, it might be inferred from the Notice's silence that work performed or amounts incurred by a transferor of only equipment may be taken into account by a related transferee.

Relocation of Equipment by a Taxpayer

The Notice provides that work performed or amounts incurred prior to January 1, 2014, by a taxpayer may be taken into account for purposes of determining whether the physical work test or 5% safe harbor have been satisfied even if the taxpayer began construction with the intent to develop the facility at one site, but thereafter transferred equipment and other components to another site where development was completed and the project was placed in service.[15] The Notice leaves unanswered the question of whether the taxpayer is required to have had a particular project in mind when it performed the work or incurred the costs, or whether it could have performed the work or incurred the costs with simply the generic plan to use the equipment or components at some site.

5% SAFE HARBOR – A SINGLE PROJECT

Perhaps the most significant change provided by the Notice is the change to the 5% safe harbor, which seems to be a concession aimed at one or more particular utility-scale wind projects. Pursuant to the Notice, if the amount paid or incurred prior to January 1, 2014, with respect to a facility that is a single project comprised of multiple facilities (e.g., a wind farm) is less than 5%, but at least 3%, of the total cost of the facility at the time it is placed in service, the PTC or ITC may be claimed with respect to some, but not all, of the facilities comprising the project.[16] Subject to satisfying the continuous efforts requirement, the PTC or ITC may be claimed on any number of individual facilities (i.e., individual wind turbines) provided that the total aggregate cost of the individual facilities 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.[17]

The change to the 5% safe harbor does not apply to a project that is not a single facility comprised of multiple individual facilities (e.g., a biomass facility comprised of one boiler and one turbine generator that are functionally interdependent).[18]

To illustrate the change to the 5% safe harbor, the following two examples were provided in the Notice:

> (a) Example 1. Developer incurs $30,000 in costs prior to January 1, 2014, to construct Project M, a five-turbine wind farm, that will be op-

[14] Notice 2014-46, § 4.03.

[15] Notice 2014-46, § 4.02.

[16] Notice 2014-46, § 5.01.

[17] Notice 2014-46, § 5.01.

[18] Notice 2014-46, § 5.02.

erated as a single project (as described in section 4.04(2) of Notice 2013-29). In October 2015, Developer places Project M in service. The total cost of Project M is $800,000, with each turbine costing $160,000. Although Developer did not pay or incur five percent of the total cost of Project M before January 1, 2014, Developer did pay or incur at least three percent of the total cost of Project M before January 1, 2014. In addition, because Developer placed Project M in service before January 1, 2016, Developer is deemed to satisfy the Continuous Efforts Test pursuant to section 3.02 of Notice 2013-60. Accordingly, Developer will be treated as satisfying the Safe Harbor with respect to three of the turbines of Project M, as their total aggregate cost of $480,000 is not greater than twenty times the $30,000 in costs incurred by Developer prior to January 1, 2014. Thus, Developer may claim the PTC on electricity produced from three of the turbines of Project M or the ITC based on $480,000, the cost of three of the turbines of Project M.

(b) Example 2. Developer incurs $25,000 in costs prior to January 1, 2014, to construct Facility N, an open-loop biomass facility, partly comprised of one boiler and one turbine generator that are functionally interdependent. In October 2015, Developer places Facility N in service. The total cost of Facility N is $600,000. Because Developer did not pay or incur five percent of the actual total cost of Facility N before January 1, 2014, and because the boiler and turbine generator are integral parts of a single facility that is not a single project comprised of multiple facilities (as described in section 4.04(2) of Notice 2013-29), Developer will not satisfy the Safe Harbor. However, if physical work of a significant nature began (within the meaning of section 4.01 of Notice 2013-29, as clarified by section 3 of this notice) before January 1, 2014, Developer may be able to claim the PTC or the ITC with respect to Facility N.[19]

CONCLUSION

It is apparent from the elements of the Notice that the IRS intended to address the specific concerns of various industry participants. In doing so, they answered some, but not all, of the questions left unanswered in the earlier Notices.

[19] Notice 2014-46, § 5.03.

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