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Tax Group Client Alert: IRS Notice 2013-29: What it Means to "Begin Construction"

On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (the "Act"),¹ which among other things includes a number of extensions and modifications related to renewable energy provisions, including the 2.3 cent-per-kilowatt-hour production tax credit (the "PTC")² and the 30% investment tax credit (the "ITC").³ The Act extends the PTC and ITC to certain otherwise qualifying renewable energy facilities, including wind facilities, for which construction begins before January 1, 2014.⁴ Prior to the Act, these facilities had to be placed in service before January 1, 2014 in order to be eligible for the PTC or ITC. (Our previous Client Alert on the Act can be found [here](#).) The Act did not define what it means to "begin construction."

On April 15, 2013, the Internal Revenue Service published Notice 2013-29 (the "Notice"), providing guidance on what it means to "begin construction" under the Act.⁵ (A copy of the Notice can be found [here](#).) Under the Notice, there are two alternative methods by which a taxpayer can demonstrate that construction has begun before January 1, 2014: (1) by beginning physical work of a significant nature before January 1, 2014 or (2) by paying or incurring at least 5% of the total cost of the facility before January 1, 2014, the latter commonly referred to as the "5% safe harbor." Similar standards applied for purposes of determining whether an applicant had "commenced construction" for purposes of cash grants payable under Section 1603 of Division B of

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 biomass facilities, geothermal facilities, landfill gas facilities, trash facilities, qualified hydropower facilities and qualified marine and hydrokinetic renewable energy facilities.

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

the American Recovery and Reinvestment Act of 2009.⁶ Our previous Client Alerts on the commencement of construction requirements for purposes of the cash grant can be found on our website ([March 2010](#) and [June 2010](#)). Although the methods described in the Notice are substantially similar to the cash grant "commencement of construction" requirements, there are certain key distinctions. The remainder of this discussion focuses on these distinctions.

PHYSICAL WORK OF A SIGNIFICANT NATURE

Under the Notice, "physical work of a significant nature" does not include work to produce inventory, whether existing inventory or property that is "normally held in inventory by a vendor." Based on the language of the Notice, if the property is produced by someone other than the taxpayer under a binding written contract, this restriction applies regardless of whether the inventory was produced before or after the binding written contract was entered into.

The Notice defines what it means to begin construction with respect to a "facility." A "facility" includes all components of property that are functionally interdependent, meaning that each component relies on the others being placed in service in order to generate electricity. As in the case of the cash grant guidance, for purposes of determining whether construction of a facility has begun before January 1, 2014, multiple facilities that are operated as part of a single project will be treated as a single facility. Especially in the case of a wind farm, this is significant because, as illustrated by the Notice, if a taxpayer performs physical work of a significant nature before January 1, 2014 on ten out of fifty wind turbines comprising a wind farm that is treated as a single project (i.e., a single facility), the taxpayer will be treated as having begun construction before January 1, 2014 with respect to the entire wind farm.⁷ The Notice provides a nonexclusive list of factors indicating that multiple facilities are operated as part of a single project.⁸

5% SAFE HARBOR

Unlike the cash grant requirements, under the Notice, in addition to incurring 5% or more of a renewable energy facility's cost before January 1, 2014, taxpayers relying on

⁶ Pub. L. No. 111-5, 123 Stat. 115 (2009).

⁷ Notice 2013-29, § 4.04(3).

⁸ Included on this list are the following factors: (a) The facilities are owned by a single legal entity; (b) the facilities are constructed on a contiguous piece of land; (c) the facilities are described in a common power purchase agreement or agreements; (d) the facilities have a common intertie; (e) the facilities share a common substation; (f) the facilities are described in one or more common environmental or other regulatory permits; (g) the facilities were constructed pursuant to a single master construction contract and (h) the construction of the facilities was financed pursuant to the same loan agreement.

the 5% safe harbor also must make "continuous efforts to advance towards completion". Whether a taxpayer is considered to make continuous efforts to advance towards completion of the renewable energy facility will be determined based on all of the facts and circumstances. However, the Notice provides a nonexclusive list of examples of continuous efforts to advance towards completion that includes, paying or incurring additional costs, entering into binding written contracts for components or future work, obtaining permits or performing physical work of a significant nature.

If the total cost of multiple facilities that are treated as a single project (as described above) exceeds the estimated cost of the project such that the amount the taxpayer paid or incurred before January 1, 2014 is less than 5% of the total cost of the project at the time it is placed in service, the 5% safe harbor will not be fully satisfied. However, the PTC or ITC may nevertheless be claimed with respect to some, but not all, of the individual facilities comprising the project, provided that the total cost of the individual facilities is not more than twenty times greater than the amount the taxpayer paid or incurred before January 1, 2014. On the other hand, if because of cost overruns or otherwise the amount spent before January 1, 2014 is less than 5% of the total cost of a completed facility that cannot be separated into smaller individual facilities, then the taxpayer will not have satisfied the 5% safe harbor with respect to any portion of the facility. Note however, that a taxpayer may nevertheless be able to claim the PTC or ITC with respect the facility (or multiple facilities) if physical work of a significant nature was performed prior to January 1, 2014.⁹

There is very limited guidance on how these rules provided by the Notice will apply to transferees (i.e., whether or under what circumstances a transferee of a facility can benefit from the transferor having satisfied the begun construction requirements). For purposes of the physical construction method, the Notice does provide that work performed under a master contract will be taken into account when rights to receive certain components under the master contract are assigned (pursuant to a binding written contract) to an affiliate special purpose vehicle that will own the facility for which the property will be used. However, the Notice provides no additional guidance in the context of transferees.

⁹ See Notice 2013-29, § 5.03(3)(a) and (b).

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