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Tax Group Client Alert:
IRS Notice 2013-60: Beginning Construction - Continuous Construction, Continuous Efforts, Master Contracts and Transfers Clarified

On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (the "Act")[1] which, among other things, extended the 2.3 cent-per-kilowatt-hour production tax credit (the "PTC")[2] and the 30% investment tax credit (the "ITC")[3] to qualifying wind and other renewable energy facilities (excluding solar, for which the ITC is available for systems placed in service prior to January 1, 2017) the construction of which begins 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.) Under Notice 2013-29, 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 (the "physical work test") or (2) by paying or incurring at least 5% of the total cost of the facility 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

[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).

[6] Notice 2013-29, § 33

continuous efforts to advance towards completion of the project, in each case after construction has begun (in the case of the 5% safe harbor, after 5% of the total costs have been paid or incurred).[7] Notice 2013-29 provided very little guidance on what activities would satisfy either of these requirements.

Notice 2013-29 also left unanswered how the new rules would apply to transferees (i.e., whether or under what circumstances a transferee could benefit from the transferor having satisfied the requirements under Notice 2013-29. Further, although Notice 2013-29 provided that, for purposes of the physical work test, work performed by a vendor/manufacturer prior to January 1, 2014 under a master contract can be taken into account by an affiliate of the original purchaser who receives an assignment after December 31, 2013 of the rights to receive any of the components under the master contract, no such statement was made with respect to the 5% safe harbor.[8] (Our prior Client Alerts on the Act and Notice 2013-29 can be found here and here.)

On September 20, 2013 the IRS published Notice 2013-60 (the "Notice") clarifying certain aspects of the guidance provided in Notice 2013-29.[9] (A copy of Notice 2013-60 can be found here.) Specifically, the Notice addresses: (1) the "continuous efforts" and "continuous construction" requirements; (2) the master contract described in Notice 2013-29 and (3) the transfer of a facility after construction has begun under the Act.

CONTINUOUS EFFORTS AND CONTINUOUS CONSTRUCTION

Under the Notice, a taxpayer is deemed to satisfy the requirement that they (1) maintain continuous efforts to advance towards completion for purposes of the 5% safe harbor or (2) maintain a continuous program of construction for purposes of the physical work test, if the project is placed in service before January 1, 2016.[10] Barring extraordinary circumstances, for projects placed in service before January 1, 2016 this "safe-harbor" will eliminate any concern regarding the pace of construction or progress to completion. A facts and circumstances analysis will be applied to projects placed in service after this deadline. No further guidance beyond what was provided in Notice 2013-29 was given as far as what activities would qualify.

[7] Notice 2013-29, §§ 4.01, 4.06 and 5.02

[8] Notice 2013-29, § 4.03(2).

[9] I.R.S. Notice 2013-60 (Sept. 20, 2013).

[10] Notice 2013-60, § 3.02.

MASTER CONTRACT

Pursuant to the Notice, the master contract provision, as described in Notice 2013-29, applies to the 5% safe harbor as well as the physical work test.[11]

TRANSFER OF FACILITY

In the Notice, the IRS noted that the statutory language requires only that construction of a facility begin before January 1, 2014; it does not require the construction to be begun by the taxpayer claiming the PTC or ITC.[12] Applying this reasoning, the Notice provides an example in which a disregarded entity begins construction of a wind energy facility prior to January 1, 2014 and 95% of the equity interests in the disregarded entity subsequently are transferred by the "developer" in a transaction treated as a transfer of a 95% undivided interest in the assets under Revenue Ruling 99-5.[13] In the Notice the IRS concludes that the entity, now an entity taxable as a partnership owned 5% by the developer, will continue to be treated as having satisfied the begun construction requirement.[14] If the facility is otherwise a qualified facility, the entity will be able to claim the PTC with respect to energy generated by the facility, or if the transfer occurs before the facility is placed in service, the entity may elect to claim the ITC in lieu of the PTC.[15]

Although the example in the Notice addresses only the transfer of 95% of the equity interests in a disregarded entity that is developing a project, the rationale expressed in the Notice should apply equally to transfers of all of a project entity's assets and to transfers of 100% of the equity interests in a project entity to a third party. What remains unclear is what constitutes a facility, e.g., to what extent can a developer with a master turbine supply agreement after December 31, 2013 transfer the right to receive some of those turbines to an affiliate (so that the affiliate then satisfies the begun construction requirement under the rules in the Notice and Notice 2013-29 applicable to master contracts) and then sell all or a portion of the interests in that affiliate to a third party. This and similar questions will no doubt continue to arise.

[11] Notice 2013-60, § 4.02.

[12] Notice 2013-60, § 5.01.

[13] Notice 2013-60, § 5.02.

[14] Notice 2013-60, § 5.02.

[15] Notice 2013-60, § 5.02.

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