

Client Alert

April 2013

Internal Revenue Service Issues Beginning of Construction Rules for Purposes of the Production Tax Credit (and Investment Tax Credit in Lieu of Production Tax Credit)

On April 15, 2013, the Internal Revenue Service (the “Service”) issued [Notice 2013-29](#) (the “Notice”), which provides guidelines and a safe harbor for purposes of determining when construction has begun on a facility. Under the [American Taxpayer Relief Act of 2012](#), Congress extended the production tax credit (“PTCs”) for wind projects until January 1, 2014, and adopted a “beginning of construction” deadline in lieu of the placed-in-service deadlines for wind, closed- and open-loop biomass, geothermal, landfill gas, trash, hydropower and marine and hydrokinetic facilities. Congress also conformed the election to claim investment tax credits (“ITCs”) in lieu of PTCs to match the new sunset date and beginning of the construction rule applicable to the PTCs.

The Notice provides rules that largely mirror the “beginning of construction” rules applicable to the Section 1603 Treasury Grant Program, but with a few clarifications, differences and omissions as highlighted and discussed below.

Similar to the Section 1603 Treasury Grant Program, the Notice generally provides two methods for establishing that construction has begun: a taxpayer may establish the beginning of construction by either (1) starting physical work of a significant nature or (2) paying or incurring 5 percent or more of the total cost of the facility.

Physical Work

The Notice provides that construction begins when physical work of a significant nature (“Physical Work”) begins. Similar to the Section 1603 Treasury Grant Program:

- Work performed by the taxpayer and work performed for the taxpayer by another person under a binding written contract “BWC” and such contract is entered into before the work takes place is taken into account.
 - A contract is binding only if it is enforceable under local law against the taxpayer (or a predecessor) and does not limit damages to a specified amount. The damages limitation amount is not specified in the Notice, but, consistent with tax law authorities is assumed to be not less than five percent of the total contract price.
- The Service will closely scrutinize a facility if a taxpayer does not maintain a “continuous program of construction.”
 - The Notice provides additional examples of when disruptions in the taxpayer’s program of construction will not affect a “continuous program of construction,” such as:
 - Severe weather conditions or natural disasters;
 - Licensing and permitting delays (including delays at the written request of a governmental agency regarding matters of safety, security or similar concerns);

- Labor stoppages;
 - Inability to obtain specialized equipment;
 - Presence of endangered species;
 - Financing delays of less than six months; and
 - Supply shortages.
- Both on-site and off-site work may be taken into account in order to demonstrate that Physical Work has begun.
 - Off-site work counts as Physical Work only if (1) the manufacturer's off-site work is performed pursuant to a BWC and (2) the components manufactured (either by the taxpayer or another person under a BWC are not in existing inventory or normally held in inventory by a vendor.
 - The Notice contains a "master contract" rule, which provides that a taxpayer may enter into a BWC for a specific number of components to be manufactured, constructed, or produced by another person. Under a new BWC, the taxpayer may assign its rights to a portion of the components under the master contract to an affiliated special purpose entity that will own the facility in which such property will be used. In such case, the work under the master contract may be taken into account by the special purpose entity.
 - The Notice does not provide guidance on the amount of ownership that is required for a special purpose vehicle to an "affiliate," but it is assumed by use of the term "affiliated" that more than 80 percent common ownership is required.
 - Physical Work does not include preliminary activities such as planning, designing, financing, exploring, researching, obtaining permits, licensing, conducting surveys, conducting studies, clearing a site, test drilling, excavating to change the contour of the land, or removing existing turbines and towers.
 - For purposes of the "beginning of construction" rules, a facility is generally defined consistent with the Service's rules, but incorporates the "single project" election under the Section 1603 Treasury Grant Program solely for purposes of the "beginning of construction" rules, taking into account various facts and circumstances.
 - The Notice lists eight non-exclusive facts and circumstances that are relevant to whether multiple projects may be considered a single project for purposes of the "beginning of construction" rules. These criteria are different and more detailed than the Section 1603 Treasury Grant program single site selection criteria.
 - The Notice provides that Physical Work must be performed on tangible personal property and other tangible property used as an integral part of the facility. Thus, the Physical Work must be on the ITC-eligible property, even if PTCs will be claimed on the facility.

5 Percent Safe Harbor

- The Notice contains the same general 5 percent safe harbor rule as the Section 1603 Treasury Grant Program. That is, the taxpayer must pay or incur 5 percent or more of the total cost of the facility (which is defined consistent with the more expansive ITC definition of eligible property rather than the PTC definition of facility equipment) before January 1, 2014. It is assumed that a cost will be treated as "incurred" where such cost is properly accrued under the economic performance standard of I.R.C. section 461(h).
 - In addition, under the 5 percent safe harbor, the Notice requires that the taxpayer make "continuous efforts to advance toward completion," which is different from the Section 1603 Treasury Grant Program 5 percent safe harbor. Whether a taxpayer has made "continuous efforts" is a facts-and-circumstances analysis based on the following factors:
 - Paying or incurring additional amounts included in the total cost of the facility;

- Entering into BWCs for components or future work on the construction of the facility;
- Obtaining necessary permits; and
- Performing Physical Work.
- The Notice provides that certain disruptions toward the “continuous efforts to advance towards completion” that are beyond the taxpayer’s control, similar to the Physical Work disruptions, will not cause a taxpayer to fail to make “continuous efforts.”
- Similar to the Section 1603 Treasury Grant Program, the Notice also allows a “look through” of economic performance for property that is manufactured, constructed or produced for the taxpayer by another person under a BWC with the taxpayer.
 - Again, similar to the Section 1603 Treasury Grant program, in examples, the Notice only provides for one “look through” of costs paid or incurred by another person. Thus, any costs paid or incurred by a subcontractor to a contractor under a BWC with the taxpayer, do not count for purposes of the 5 percent safe harbor.
- Again, similar to the Section 1603 Treasury Grant Program, if there are cost overruns on a single project that consists of multiple facilities that result in the 5 percent safe harbor not being met for the project, PTCs or ITCs may be claimed with respect to some of the individual facilities as long as the aggregate cost of those facilities is not more than 20 times greater than the amount the taxpayer paid or incurred before January 1, 2014.

There are a few open items not provided or discussed in the Notice. The Notice does not define what constitutes an “affiliated” special purpose entity for purposes of the master contract provision. In addition, the Notice does not discuss how sales of or investments in safe-harbored projects will be treated for purposes of the “beginning of construction” rules.

Click the following link for a copy of the Notice. If you have any questions regarding the Notice, please contact us.

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