

IRS releases guidance on beginning of construction standards for PTC

April 16, 2013

In brief

The American Taxpayer Relief Act of 2012 amended the Section 45 renewable electricity production tax credit (PTC) and the election to claim the energy investment tax credit (ITC) in lieu of the PTC to apply to facilities on which construction begins before January 1, 2014. Since this change, there has been uncertainty regarding the rules that the IRS would apply to determine when construction has begun. In Notice 2013-29, the IRS has now provided applicable guidance implementing both a physical work standard and providing an economic safe harbor in meeting the new ATRA deadline for the PTC and ITC.

In detail

The IRS has created two methods for taxpayers to show that they have begun construction for purposes of the PTC or elective ITC. This approach is similar to that used by the Department of Treasury in implementing the begun construction rules of the Section 1603 grant program, which involved PTC- or ITC-qualified facilities.

Physical work of a significant nature

The first method authorized by the IRS states that construction of a qualified facility begins when physical work of a significant nature begins. The work may be performed by the facility owner or by other persons under binding written contract.

Preliminary activities, such as planning, designing, surveying, etc., are not considered to be physical work of a significant nature. Physical work performed off-site, if otherwise meeting the standard, may suffice. This could be an activity such as the assembly of components by a vendor under a binding written contract.

The physical work must also relate to property that is integral to the activity to be performed by the facility, such as electricity generation.

Once physical work of a significant nature is begun, the facility owner must maintain a continuous program of construction. The notice does allow that certain disruptions in construction that are beyond the facility owner's control—natural disasters, severe weather, labor

stoppages, regulatory delays, etc.—will not generally cause a failure to maintain a continuous program of construction.

'5%' safe harbor

Alternatively, the IRS will conclude that construction of a facility has begun when the facility owner pays or incurs 5% or more of the total cost of the facility. Costs that are incurred by other persons under binding written contract may be taken into account in determining the total costs paid or incurred (the 'look-through' provision).

Similar to the physical work standard, the IRS will require facility owners to maintain continuous efforts towards completion once the 5% cost threshold has been reached. The IRS also provides the same recognition that some events

may occur beyond the control of the facility owner that could disrupt progress towards completion.

The IRS also notes that cost overruns of facilities may result in the safe harbor not being met, as the initial costs incurred will no longer meet or exceed 5% of the larger total cost of the facility. If the facility is comprised of units that may be seen as smaller independent facilities themselves, the safe harbor could apply to a portion of those facilities where the aggregate total cost is no more than twenty times the initial costs incurred.

The takeaway

As expected, the IRS has drawn upon Treasury's experience with the section 1603 grant program in developing a begun construction rule for the ATRA-amended PTC.

Companies, joint ventures, and others interested in pursuing the PTC or ITC now have a choice to make in determining how to document the beginning of their facility. The IRS has stated that a facility owner need only meet either test to establish qualification.

The physical work standard is the more subjective of the two methods. The IRS states that it will rely on scrutiny of the facts and circumstances to determine whether the standard is met, in terms of distinguishing between preliminary activities and significant activities, whether property is integral to the facility, and whether construction has been continuous.

The safe harbor, while based on objective calculations, nevertheless is vulnerable to cost overruns.

Both methods contain a 'look through' provision where the activity or costs incurred by third parties may be used to satisfy the standard. These both rely on the presence of a valid contract that will be respected by the IRS as well as the verification of the actions of the third party.

Taxpayers should note that while the Notice provides some relief for events outside the taxpayer's control, that relief does not appear to extend to other common project issues such as third-party delays in completing transmission lines or delays caused by

the bankruptcy of a supplier or contractor.

The notice provides some examples to illustrate portions of the rules. However, in practice, construction of alternative energy facilities is typically more complex than these examples, and some of the definitions provided by the IRS will further interpretation by IRS Counsel. Because these issues frequently affect developers' ability to obtain financing, it would be useful if the IRS would signal its willingness to issue prompt private guidance on such issues.

Additional resources

For prior alerts on alternative and renewable energy tax issues, please see our [news archive](#).

In addition to the *Alternative & Renewable Energy Tax Newsalert*, PwC also publishes a cross-disciplinary Newsalert providing updates on cleantech, sustainable development, and the business impacts of US climate and energy policy. [Access](#) further information and sign up for these alerts.

Let's talk

For a deeper discussion about using energy tax incentives to meet your renewable energy goals, please contact :

Matthew Haskins
(202) 414-1570
matthew.haskins@us.pwc.com

Kerry Gordon
(720) 931-7364
kerry.m.gordon@us.pwc.com

Wendy Punches
(408) 817-5948
wendy.punches@us.pwc.com

Courtney Sandifer
(202) 414-1315
courtney.sandifer@us.pwc.com

Jason Spitzer
(202) 346-5287
jason.spitzer@us.pwc.com

© 2013 PricewaterhouseCoopers LLP. All rights reserved. In this document, PwC refers to PricewaterhouseCoopers (a Delaware limited liability partnership), which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

SOLICITATION

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.