

Beginning of Construction for Sections 45 and 48

Notice 2016-31

SECTION 1. PURPOSE

Section 38 of the Internal Revenue Code (the Code) allows certain business credits against the tax imposed by Chapter 1 of the Code. Among the credits allowed by § 38 is the credit for renewable electricity production described in § 45(a). To qualify for the renewable electricity production tax credit, electricity must, among other things, be produced by the taxpayer at a qualified facility. Section 45(a)(2)(A). Section 45(d) defines qualified facilities for purposes of § 45.

Prior to the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (ATRA), § 45(d) required a facility to be placed in service before January 1, 2014, in order to be a qualified facility, except for qualified wind facilities which had to be placed in service before January 1, 2013. ATRA modified the definition of certain qualified facilities under § 45(d) by replacing the placed in service requirement with a beginning of construction requirement. ATRA provided that a taxpayer is eligible to receive the renewable electricity production tax credit (PTC) under § 45, or the energy investment tax credit (ITC) under § 48 in lieu of the PTC, with respect to certain renewable energy facilities if construction of such facility began before January 1, 2014. On December 19, 2014, the Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, 128 Stat. 4021 (TIPA), extended by one year, to January 1, 2015, the date by which construction of a qualified facility must begin.

On December 18, 2015, the Protecting American from Tax Hikes Act of 2015, Pub. L. No. 114-113, Div. Q, 129 Stat. 2242 (the PATH Act), enacted amendments to the PTC and the ITC for certain renewable energy facilities. The PATH Act extended the PTC for two years with respect to certain facilities the construction of which begins before January 1, 2017, and further extended the PTC for wind facilities the construction of which begins before January 1, 2020. The PATH Act also modified the PTC for wind facilities by providing that the credit will phase out over the next four years.¹ The PATH Act also extended the ITC for solar energy facilities the construction of which begins before January 1, 2022. The Treasury Department and the Internal Revenue Service (Service) anticipate issuing separate guidance addressing the extension of the ITC for solar energy facilities.

The Service will not issue private letter rulings to taxpayers regarding the application of this notice or the application of the beginning of construction requirement under §§ 45(d) and 48(a)(5) as provided in Notice 2013-29, 2013-1 C.B. 1085; Notice 2013-60, 2013-2 C.B. 431; Notice 2014-46, 2014-2 C.B. 520; and Notice 2015-25, 2015-13 I.R.B. 814 (collectively “the prior IRS notices”).

SECTION 2. BACKGROUND

¹ As a result, facilities the construction of which begins before January 1, 2017, are eligible to receive 100% of the PTC; facilities the construction of which begins after December 31, 2016, and before January 1, 2018, are eligible to receive 80% of the PTC; facilities the construction of which begins after December 31, 2017, and before January 1, 2019, are eligible to receive 60% of the PTC; and facilities the construction of which begins after December 31, 2018, and before January 1, 2020, are eligible to receive 40% of the PTC.

On May 13, 2013, the Treasury Department and the Service published Notice 2013-29, which provides two methods that a taxpayer may use to establish that construction of a qualified facility has begun. A taxpayer may establish the beginning of construction by beginning physical work of a significant nature as described in section 4 of Notice 2013-29 (Physical Work Test). Alternatively, a taxpayer may establish the beginning of construction by meeting the safe harbor provided in section 5 of Notice 2013-29 (Five Percent Safe Harbor). Both methods require that a taxpayer make continuous progress towards completion once construction has begun, as set forth in section 4.06 of Notice 2013-29 (Continuous Construction Test) for taxpayers using the Physical Work Test and section 5.02 of Notice 2013-29 (Continuous Efforts Test) for taxpayers using the Five Percent Safe Harbor (collectively, the Continuity Requirement).

On October 28, 2013, the Treasury Department and the Service published Notice 2013-60, which provides a safe harbor for satisfying the Continuity Requirement (the Continuity Safe Harbor). Under the Continuity Safe Harbor in section 3.02 of Notice 2013-60, if a facility was placed in service before January 1, 2016, the facility will be considered to satisfy the Continuity Requirement. Failure to satisfy the Continuity Safe Harbor does not mean that a facility has not satisfied the Continuity Requirement, however. If a facility was not placed in service before January 1, 2016, whether the facility satisfies the Continuity Requirement will be determined by the relevant facts and circumstances, as described in sections 4.06 and 5.02 of Notice 2013-29.

After the publication of Notice 2013-60, the Treasury Department and the Service

received requests for further clarification regarding how to satisfy the Physical Work Test, as well as questions regarding the effect of various types of transfers with respect to a facility after construction has begun. On September 2, 2014, the Treasury Department and the Service published Notice 2014-46 to clarify the application of the Physical Work Test and the effect that certain transfers with respect to a facility after construction has begun will have on a taxpayer's ability to qualify for the PTC or the ITC.

In response to a significant number of questions received after the extension of the PTC and the ITC by TIPA, on March 30, 2015, the Treasury Department and the Service published Notice 2015-25 to extend by one year the Continuity Safe Harbor provided in Notice 2013-60. Under the extended Continuity Safe Harbor in Notice 2015-25, if a taxpayer began construction on a facility prior to January 1, 2015, and places the facility in service before January 1, 2017, the facility will be considered to satisfy the Continuity Requirement, regardless of the amount of physical work performed or the amount of costs paid or incurred with respect to the facility after December 31, 2014, and before January 1, 2017.

Similarly, in response to a significant number of questions received after the extension of the PTC and the ITC by the PATH Act, this notice further extends and modifies the Continuity Safe Harbor and provides additional guidance regarding the application of the Continuity Safe Harbor and the Physical Work Test. This notice also clarifies the application of the Five Percent Safe Harbor to retrofitted renewable energy

facilities. Except as otherwise specified in this notice, the guidance provided in the prior IRS notices continues to apply.

SECTION 3. EXTENSION AND MODIFICATION OF THE CONTINUITY SAFE HARBOR

On December 18, 2015, the PATH Act extended the PTC for two years with respect to certain facilities the construction of which begins before January 1, 2017, and further extended the PTC for wind facilities the construction of which begins before January 1, 2020, with the PTC phasing out over the next four years. This notice extends the Continuity Safe Harbor provided in section 3.02 of Notice 2013-60. Accordingly, if a taxpayer places a facility in service during a calendar year that is no more than four calendar years after the calendar year during which construction of the facility began, the facility will be considered to satisfy the Continuity Safe Harbor. For example, if construction begins on a facility on January 15, 2016, and the facility is placed in service by December 31, 2020, the facility will be considered to satisfy the Continuity Safe Harbor.

SECTION 4. ADDITIONAL ISSUES REGARDING THE CONTINUITY REQUIREMENT

.01 Combination of methods. A taxpayer may not rely upon the Physical Work Test and the Five Percent Safe Harbor in alternating calendar years to satisfy the beginning of construction requirement or the Continuity Requirement. For example, if a taxpayer performs physical work of a significant nature on a facility in 2015, and then pays or incurs five percent or more of the total cost of the facility in 2016, the Continuity Safe Harbor will be applied beginning in 2015, not in 2016.

.02 Disruptions to Continuous Construction or Continuous Efforts Tests.

(1) In general. Section 4.06(1) of Notice 2013-29 provides that whether a taxpayer satisfies the Continuity Requirement will be determined by the relevant facts and circumstances.

(2) Excusable disruptions. Sections 4.06(2) and 5.02(2) of Notice 2013-29 provide a non-exclusive list of construction disruptions that will not be considered as indicating that a taxpayer has failed to maintain a continuous program of construction or continuous efforts to advance towards completion of the facility. This notice revises that list, which remains non-exclusive, and provides additional excusable disruptions:

(a) severe weather conditions;

(b) natural disasters;

(c) delays in obtaining permits or licenses from federal, state, local, or Indian tribal governments, including, but not limited to, delays in obtaining permits or licenses from the Federal Energy Regulatory Commission (FERC), the Environmental Protection Agency (EPA), the Bureau of Land Management (BLM), and the Federal Aviation Agency (FAA);

(d) delays at the written request of a federal, state, local, or Indian tribal government regarding matters of public safety, security, or similar concerns;

(e) interconnection-related delays, such as those relating to the completion of construction on a new transmission line or necessary transmission upgrades to resolve grid congestion issues that may be associated with a project's planned interconnection;

- (f) delays in the manufacture of custom components;
- (g) labor stoppages;
- (h) inability to obtain specialized equipment of limited availability;
- (i) the presence of endangered species;
- (j) financing delays; and
- (k) supply shortages.

SECTION 5. PHYSICAL WORK TEST

.01 In general. The Physical Work Test requires that a taxpayer begin physical work of a significant nature. As provided in section 3 of Notice 2014-46, this test focuses on the nature of the work performed, not the amount or the cost. Assuming the work performed is of a significant nature, there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the Physical Work Test.

.02 Examples. The following list of examples is intended to illustrate physical work of a significant nature for different types of renewable energy facilities and is non-exclusive.

(1) Wind facilities. On-site physical work of a significant nature may include the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation.

(2) Hydropower facilities. On-site physical work of a significant nature may include the excavation for or construction of a penstock, power house, or retaining wall structure.

(3) Biomass and trash facilities. On-site physical work of a significant nature may include the performance of site improvements (as opposed to site clearing), such as filling or compacting soil, or installing stack piling.

(4) Geothermal facilities. On-site physical work of a significant nature may include physical activities that are undertaken at a project site after a valid discovery.

.03 Preliminary activities. As provided in section 4.02(1) of Notice 2013-29, physical work of a significant nature does not include preliminary activities, even if the cost of those preliminary activities is properly included in the depreciable basis of the facility. Generally, preliminary activities include, but are not limited to:

- (1) planning and designing;
- (2) securing financing;
- (3) exploring;
- (4) researching;
- (5) conducting geologic mapping and modeling;
- (6) obtaining permits and licenses;
- (7) conducting geophysical, gravity, magnetic, seismic and resistivity surveys;
- (8) conducting environmental and engineering studies;
- (9) performing activities to develop a geothermal deposit prior to valid discovery;
- (10) clearing a site;
- (11) conducting test drilling to determine soil condition;
- (12) excavating to change the contour of the land (as distinguished from

excavation for footings and foundations); and

(13) removing existing turbines and towers, solar panels, or any components that will no longer be part of the facility.

.04 Facility.

(1) In general. As provided in section 4.04 of Notice 2013-29, a facility (within the meaning of § 45(d)) generally includes all components of property that are functionally interdependent. Components of property are functionally interdependent if the placing in service of each of the components is dependent upon the placing in service of each of the other components in order to generate electricity.

(2) Single project. Solely for purposes of determining whether construction of a facility has begun for purposes of §§ 45 and 48, multiple facilities that are operated as part of a single project (along with any property, such as a computer control system, that serves some or all such facilities) will be treated as a single facility. Whether multiple facilities are operated as part of a single project will depend on the relevant facts and circumstances. The single project rule may be applied to facilities that rely upon either the Physical Work Test or the Five Percent Safe Harbor to satisfy the Continuity Requirement.

(3) Timing of single project determination. The determination of whether multiple facilities are operated as part of a single project and are therefore treated as a single facility for beginning of construction purposes under section 5.04(2) must be

determined in the calendar year during which the last of the multiple facilities is placed in service.

(4) Disaggregation. Multiple facilities that are operated as part of a single project and treated as a single facility under section 5.04(2) for purposes of determining whether construction of a facility has begun may be disaggregated and treated as multiple separate facilities for purposes of determining whether a facility satisfies the Continuity Safe Harbor. Those disaggregated facilities that are placed in service prior to the Continuity Safe Harbor deadline will be eligible for the Continuity Safe Harbor. The remaining disaggregated facilities may satisfy the Continuity Requirement under a facts and circumstances determination. The disaggregation rule may be applied to facilities that rely upon either the Physical Work Test or the Five Percent Safe Harbor to satisfy the Continuity Requirement.

(a) Example. X is developing a wind farm that will consist of 50 turbines, associated towers and supporting pads, a computer system that monitors and controls the turbines, and associated power conditioning equipment. The entire wind farm will be connected to the power grid through a single intertie, and power generated by the wind farm will be sold to a local utility through a single power purchase agreement. Using the single project rule in section 5.04(2), the entire wind farm is a single project that will be treated as a single facility. On June 1, 2018, X excavates the site for the foundations of 10 of the 50 turbines and pours concrete for the supporting pads. Accordingly, X has performed physical work of a significant nature that constitutes the

beginning of construction of the single facility for purposes of §§ 45 and 48.

Thereafter, X places in service only 40 of the 50 turbines and related facilities before January 1, 2023. X disaggregates the 50 turbines under section 5.04(4). Forty of the 50 turbines satisfy the Continuity Safe Harbor. For the remaining 10 turbines, X may demonstrate that it satisfies the Continuous Construction Test described in section 4.06 of Notice 2013-29 based on the facts and circumstances.

SECTION 6. APPLICATION OF FIVE PERCENT SAFE HARBOR TO RETROFITTED FACILITIES

.01 In general. A facility may qualify as originally placed in service even though it contains some used property, provided the fair market value of the used property is not more than 20 percent of the facility's total value (the cost of the new property plus the value of the used property) (80/20 Rule). See Rev. Rul. 94-31, 1994-1 C.B. 16; Notice 2008-60, 2008-2 C.B. 178. In the case of a single project comprised of multiple facilities (as described in section 5.04(2)), the 80/20 Rule is applied to each individual facility comprising the single project.

.02 Application of beginning of construction to retrofitted facilities. To satisfy beginning of construction for §§ 45 and 48, the Five Percent Safe Harbor is applied only with respect to the cost of new property used to retrofit an existing facility. Therefore, only expenditures paid or incurred that relate to new construction should be taken into account for purposes of the Five Percent Safe Harbor.

(1) Example. Taxpayer owns an existing wind farm comprised of 13 turbines, pads, and towers for which the eligibility periods for the PTC or the ITC have elapsed.

Each facility has a fair market value of \$1 million. Taxpayer replaces components worth \$900,000 at each of 11 of the facilities at a cost of \$1.4 million for each facility. Two of the 13 facilities are not upgraded. The fair market value of the remaining original components at each of the upgraded facilities is \$300,000. The total expenditures to retrofit the 11 facilities are \$15.4 million (\$1.4 million x 11). Taxpayer applies the single project rule provided in section 5.04(2).

The fair market value of the remaining original components of each individual upgraded facility (\$300,000) is not more than 20% of each facility's total value of \$1.7 million (the cost of the new components (\$1.4 million) + the value of the remaining original components (\$300,000)). Thus, each upgraded facility will be considered newly placed in service for purposes of §§ 45 and 48. Accordingly, if the taxpayer pays or incurs at least \$770,000 (5% of \$15.4 million) of qualified expenditures in 2016, construction of the single facility will be considered to have begun in 2016, and if the taxpayer also satisfies the Continuous Efforts Test, each of the 11 upgraded facilities will be a qualified facility within the meaning of § 45(d). No additional PTC will be allowed with respect to energy produced by the taxpayer at the two facilities that were not upgraded. Nor will those two facilities qualify for additional ITC.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Notice 2013-29, Notice 2013-60, Notice 2014-46, and Notice 2015-25 are clarified and modified.

SECTION 8. DRAFTING INFORMATION

The principal author of this notice is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Bernardini on (202) 317-6853 (not a toll-free call).