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IRS Modifies Continuity Requirement and Clarifies Other Guidance for Production Tax Credit Eligibility

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On May 5, 2016, the IRS released Notice 2016-31 to update and clarify prior IRS guidance concerning satisfaction of the “begun construction” requirement for production tax credit (“PTC”) eligibility under recently extended begun construction deadlines¹.



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On December 18, 2015, the Protecting Americans from Tax Hikes Act of 2015 (the “PATH Act”) extended PTC eligibility for facilities that are under construction before 2020, but introduced a phase-out that reduces the rate of the PTC based on the year in which construction of the facility began. In particular, the rate of the PTC is reduced to 80% of the current rate for facilities beginning construction in 2017, 60% of the current rate for facilities beginning construction in 2018, and 40% of the current rate for facilities beginning construction in 2019.



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IRS guidance issued prior to the PATH Act provided two methods for establishing that construction had begun on a facility for purposes of this requirement: (a) beginning physical work of a significant nature on the facility (the “Physical Work Test”) or (b) paying or incurring five percent or more of the total costs of the facility (the “5% Safe Harbor”), in each case, prior to the then-current deadline. Both methods also require that a taxpayer make continuous progress toward completion of the facility after commencing construction (the “Continuous Construction Requirement”). In

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subsequent IRS guidance, the IRS provided that facilities were “deemed” to satisfy the Continuous Construction Requirement if they were placed in service within two years of the then-current deadlines for having commenced construction (the “Continuity Safe Harbor”). Thus, the Continuity Safe Harbor provided a useful exception to certain facts and circumstances tests that a taxpayer would otherwise have to meet in order to demonstrate satisfaction of the Continuous Construction Requirement.

The latest IRS guidance modifies the Continuity Safe Harbor and provides additional clarification on certain other begun construction points not fully addressed in prior IRS guidance.

Continuity Safe Harbor

Under the latest guidance, there is no longer a single specific date by which a facility must be placed in service in order to meet the Continuity Safe Harbor. Instead, the notice provides that the Continuity Safe Harbor will be satisfied if the facility is placed in service no more than four calendar years after the calendar year in which construction of the facility begins. Thus, for example, if construction of a facility began on January 1, 2016, the facility would satisfy the Continuity Safe Harbor as long as the facility is placed in service by December 31, 2020, and the taxpayer would not be required to demonstrate continuous construction under a facts and circumstances analysis.

The notice specifies that a taxpayer may not satisfy the Continuous Construction Requirement by applying the Physical Work Test and the 5% Safe Harbor in alternative years. This prohibition is intended to prevent a taxpayer from extending the four-year tolling period for the new Continuity Safe Harbor by relying on one test in a given year and thereafter applying the other test in a subsequent year. The notice provides, for example, that if a taxpayer satisfies the Physical Work Test in 2015 and then satisfies the 5% Safe Harbor in 2016, the four-year period for the Continuity Safe Harbor begins in 2015.

Facts and Circumstances Tests

If a taxpayer does not satisfy the new Continuity Safe Harbor, then the taxpayer may still satisfy the Continuous Construction Requirement by establishing that construction has been continuous based on the relevant facts and circumstances under the tests provided in existing IRS guidance. These existing continuous construction tests generally allow for certain disruptions that are beyond the taxpayer’s control. The existing guidance provides a non-exclusive list of examples of such disruptions, and the new notice introduces additional examples of disruptions related to interconnection delays and delays in the manufacturing of custom components.

Definition of Facility

The new notice also addresses the definition of “facility.” Specifically, the notice reiterates the existing rule that multiple facilities operated as a

“single project” are treated as a single facility for purposes of the Physical Work Test and the 5% Safe Harbor, and clarifies that the “single project” determination is made during the calendar year in which the last of such facilities is placed in service.

Finally, the notice permits the “disaggregation” of multiple facilities treated as a “single project” under this rule when applying the Continuity Safe Harbor. That is, any of the individual facilities in a project that do not satisfy the Continuity Safe Harbor may be “disaggregated” from the facilities satisfying the Continuity Safe Harbor and still satisfy the Continuous Construction Requirement under one of the facts and circumstances tests described above.

Retrofitted Facilities

As provided in earlier guidance and notices, “retrofitted” facilities that contain some used property may also qualify for PTCs under the 5% Safe Harbor, where the fair market value of any used property in a facility does not constitute more than 20% of the facility’s value (the “80/20 Rule”). The new notice clarifies that, with respect to a “retrofitted” facility that satisfies the 80/20 rule, the 5% Safe Harbor is applied only with respect to the cost of the new property.

Physical Work Test

The latest guidance also reiterates that certain “preliminary activities” are not sufficient to constitute physical work of a significant nature, and lists examples substantially similar to those listed in prior IRS notices.

¹ Notice 2016-31 is available here. The IRS expects to issue separate guidance in the future to address issues relevant to the extension of the ITC for solar energy facilities.

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