

# Alerts & Publications



## IRS Provides Relief for Beginning of Construction

June 2, 2020

### KEY CONTACTS

#### Arthur V. Hazlitt

New York

D: +1-212-326-2048

#### Alexander Roberts

New York

D: +1-212-326-2030

#### Dawn Lim

New York

D: +1-212-728-5905

On May 27, the IRS issued Notice 2020-41 (the “Notice”), providing welcome relief to developers of wind and solar projects seeking to qualify for the PTC or the ITC under the “beginning of construction” requirements set forth in the Code and previous IRS guidance.<sup>1</sup> As discussed further below, qualification for the PTC and ITC (and the amount of credit that may be claimed) with respect to a wind or solar project hinges on whether the project is deemed to have “begun construction” prior to certain statutory deadlines. Many developers have faced unexpected challenges in meeting such deadlines as a result of delays caused by the COVID-19 pandemic. The Notice ameliorates some of the fallout from such delays by (i) extending the “continuity safe harbor” set forth in prior IRS guidance for projects that began construction in 2016 or 2017, and (ii) providing a safe harbor for developers seeking to establish beginning of construction by incurring costs prior to the relevant deadline under the “3 ½ month rule” (discussed further below).

### Beginning of Construction and PTC/ITC Phase-Outs

In order to claim the full PTC, a wind project must have begun construction prior to 2017. The amount of PTC for which a wind project is eligible is reduced by 20% for projects beginning construction in 2017, 40% for projects beginning construction in 2018 and 60% for projects beginning construction in 2019. Wind projects that begin construction after 2019 are not eligible for the PTC.<sup>2</sup>

Solar projects that began construction prior to 2020 are eligible for the full ITC equal to 30% of qualifying basis. The ITC is reduced to 26% for solar projects beginning construction in 2020 and 22% for projects beginning construction in 2021.<sup>3</sup> Solar projects that do not meet these beginning of construction deadlines are eligible for an ITC equal to 10% of qualifying basis.

The criteria to determine when a wind or solar project begins construction for the PTC or ITC are not set forth in the Code. However, the IRS has issued a series of notices providing rules used to establish when a project is deemed to have begun construction. Under the IRS guidance, a taxpayer can establish beginning of construction of a project by starting physical work of a significant nature (the “Physical Work Test”) or paying or incurring 5% or more of applicable project costs (the “5% Safe Harbor”).

In addition, IRS guidance provides that a taxpayer must meet continuous construction (in the case of the Physical Work Test) or continuous efforts (in the case of the 5% Safe Harbor) requirements. In each case, this determination is based on a facts and circumstances analysis unless the taxpayer meets a safe harbor set forth in the IRS guidance (the “Continuity Safe Harbor”).

## Continuity Safe Harbor Extension

Given the inherent uncertainty surrounding a facts and circumstances analysis, developers generally seek to establish satisfaction of the Continuity Safe Harbor. The general rule is that the Continuity Safe Harbor is established if the project is placed in service prior to the end of the fourth calendar year following the year in which a taxpayer meets the Physical Work Test or the 5% Safe Harbor.<sup>4</sup>

The Notice provides some relief to projects that would otherwise fail the Continuity Safe Harbor due to delays caused by the COVID-19 pandemic. In particular, in the case of projects that began construction under the aforementioned tests in 2016 or 2017, the Notice extends the deadline to meet the Continuity Safe Harbor by an additional year. Thus, such projects will meet the Continuity Safe Harbor if they are placed in service by the end of the fifth calendar year following beginning of construction.

## Safe Harbor for “Costs Incurred”

As discussed above, one method of establishing beginning of construction is paying or incurring 5% or more of applicable project costs prior to the relevant deadline. As a general rule, taxpayers are deemed to have incurred costs for property or services when the property or services are provided to the taxpayer. However, an alternative rule that many developers utilize allows taxpayers to treat costs as incurred for property or services at the time of payment if the taxpayer reasonably expects the property or services to be provided within 3 ½ months of payment (the “3 ½ Month Rule”). For instance, if a developer paid a turbine supplier for equipment on December 31, 2016, the developer would be deemed to have incurred such costs for the equipment in 2016 so long as the developer reasonably expected the equipment to be provided by April 15, 2017.

Recognizing that the COVID-19 pandemic has created significant supply chain delays that may create uncertainty as to whether the 3 ½ Month Rule has been established, the IRS has provided in the Notice that for purposes of the 5% Safe Harbor, the 3 ½ Month Rule will be deemed satisfied if payment is made for property or services on or after September 16, 2019 and the property or services are provided by October 15, 2020. We note that the safe harbor set forth in the Notice does not otherwise change the application of the 3 ½ Month Rule. That is, if a taxpayer reasonably expects property or services to be provided with 3 ½ months of payment, the 3 ½ Month Rule will be satisfied regardless of whether the Notice’s safe harbor is satisfied.

---

<sup>1</sup> The Notice also applies to projects utilizing other renewable energy resources that are subject to similar beginning of construction requirements.

<sup>2</sup> If a taxpayer elects to claim the ITC in lieu of the PTC for a wind project, the ITC is reduced in a similar manner.

<sup>3</sup> In all cases, in order to qualify for such ITC amounts, the solar project must be placed in service prior to 2024.

<sup>4</sup> Depending on the credit being claimed, there are various restrictions on a taxpayer alternating between the Physical Work Test and the 5% Safe Harbor in order to extend the Continuity Safe Harbor.

---

*This memorandum is a summary for general information and discussion only and may be considered an advertisement for certain purposes. It is not a full analysis of the matters presented, may not be relied upon as legal advice, and does not purport to represent the views of our clients or the Firm. Arthur V. Hazlitt, an O'Melveny partner licensed to practice law in New York, Alexander Roberts, an O'Melveny counsel licensed to practice law in New York, and Dawn Lim, an O'Melveny associate licensed to practice law in New York, contributed to the content of this newsletter. The views expressed in this newsletter are the views of the authors except as otherwise noted.*

© 2020 O'Melveny & Myers LLP. All Rights Reserved. Portions of this communication may contain attorney advertising. Prior results do not guarantee a similar outcome. Please direct all inquiries regarding New York's Rules of Professional Conduct to O'Melveny & Myers LLP, Times Square Tower, 7 Times Square, New York, NY, 10036, T: +1 212 326 2000.