

Global Project Finance

September 20, 2013

IRS Provides Helpful Clarification to PTC “Start of Construction” Rules

Today, the IRS in Notice 2013-60 clarified three critical issues in its guidance as to whether a wind project (or other type production tax credit (PTC) eligible project) is considered to have “started construction” in 2013 enabling it to qualify for PTCs (or to make an election to claim the investment tax credit). These changes should provide developers, lenders and tax equity investors with additional certainty and result in more projects being financed and constructed. Notice 2013-60 is available [here](#).

The first change is an expanded safe harbor for projects that start construction in 2013 and are placed in service by the end of 2015. The second change is confirmation that a transfer of a project will not jeopardize its “start of construction” status. Finally, the notice clarifies that the “master contract” rules apply both to projects that opt to undertake “physical work of a significant nature” in 2013 or projects that opt to meet the five percent safe harbor in 2013.

The IRS’ original start of construction guidance was in Notice 2013-29 that was issued on April 15, 2013. That notice was subsequently clarified as to the definition of the term “binding written contract” as used in the notice. Prior client alerts discussing the original Notice 2013-29 and the clarification thereto are available [here](#) and [here](#).

1. Safe Harbor for Projects “Placed in Service” by the end of 2015

To be eligible for the production tax credit, the owner of a wind project must start construction in 2013. There are two ways to do that. You may either (i) undertake physical work of a significant nature in 2013 or (ii) you may incur eligible costs equal to five percent of tax basis of the project. If you opt for “physical work,” you are then obligated to maintain a program of “continuous construction” until completion. If you opt to incur the five percent, you are obligated to use “continuous efforts” until completion, which is a slightly more lenient standard than “continuous construction.” Notice 2013-60 provides that as long as the project is “in service” by the end of 2015, the project will be deemed to have met its continuous construction or efforts obligation.

This change is quite helpful for the industry. It provides developers and financiers with an objective standard. If the project will be complete by the end of 2015, there is no need to wring one’s hands about suspending construction for a few months while dealing with permitting, transmission or off-take issues.

Further, so long as a project meets the five percent safe harbor in 2013 and is “placed in service” by the end of 2015, law firms should be able to render tax opinions as to PTC eligibility sufficient to satisfy the underwriting requirements of tax equity investors. The five percent safe harbor is relatively objective and

can generally be determined by analyzing contracts and invoices. "Placed in service" generally means the project is physically complete and is capable of selling commercial amounts of power at commercial prices. There is some ambiguity in that definition, but by relying on a report from an independent engineer law firms are typically able to render at least "should" level opinions on the issue.

It should be noted that for projects that are placed in service after 2015, Notice 2013-60 makes the requirements no more onerous than they were originally under Notice 2013-29: the project must meet the applicable "continuous" work standard from the end of 2013 to completion in 2016 or later. For projects that relied on "physical work of a significant nature" in 2013 to meet the start of construction requirement, the developer must continue to undertake such work to meet the applicable "continuous" requirement. For projects that relied on the 5% safe harbor in 2013, the "continuous" requirement includes paying additional amounts included in the facility's cost, entering into contracts for construction of the facility, pursuing permits and any work meeting the definition of "physical work of a significant nature." Developers planning to place projects in service after 2015 should be prepared for probing questions from potential tax equity investors and later from the IRS.

2. Transfers of Projects

The original notice was silent as to what happened to a project's "start of construction status," if a project was transferred from one taxpayer to another. Notice 2013-60 makes this a very simple analysis. The start of construction status belongs to the project and the project retains that status regardless of transfers between taxpayers.

The approach to transfers in Notice 2013-60 is more lenient than the transfer rules in the Cash Grant guidance. The Cash Grant transfer rules are discussed in a client alert available here. Generally, the transferor had to either maintain more than a 20 percent interest or transfer substantial development rights. Fortunately, neither requirement applies in the PTC context. It is likely the IRS did not extend the Cash Grant transfer requirements to PTC projects because the PTC start of construction rules have protections not present in the Cash Grant rules. PTC projects must meet the applicable "continuous" standard or be in service by the end of 2015, while the Cash Grant have neither a "continuous" requirement nor a placed in service deadline.

3. Master Contracts

Notice 2013-29 enabled a parent company to enter into a master contract with a turbine supplier, a balance of plant contractor or other contractor and use that contract to meet the 2013 start of construction requirement with respect to *physical work of a significant nature*. This was permitted even though the pertinent portion of the contract would ultimately be assigned by the parent company to the special purpose affiliate that would develop and own the project.

There was no reference to the applicability of the master contract rules to projects that sought to meet the five percent safe harbor. As described in our client alert here, this led to the question of whether the

master contract rules applied to the five percent safe harbor. There was no policy reason for them not to, and Notice 2013-60 confirms that the master contract rules apply to both approaches to starting construction.

Notice 2013-60 is welcome news for an industry facing its shares of challenges. It should result in a steady stream of wind projects coming on line at least through the end of 2015 and leaves open the possibility for projects qualifying for PTCs after 2015.

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