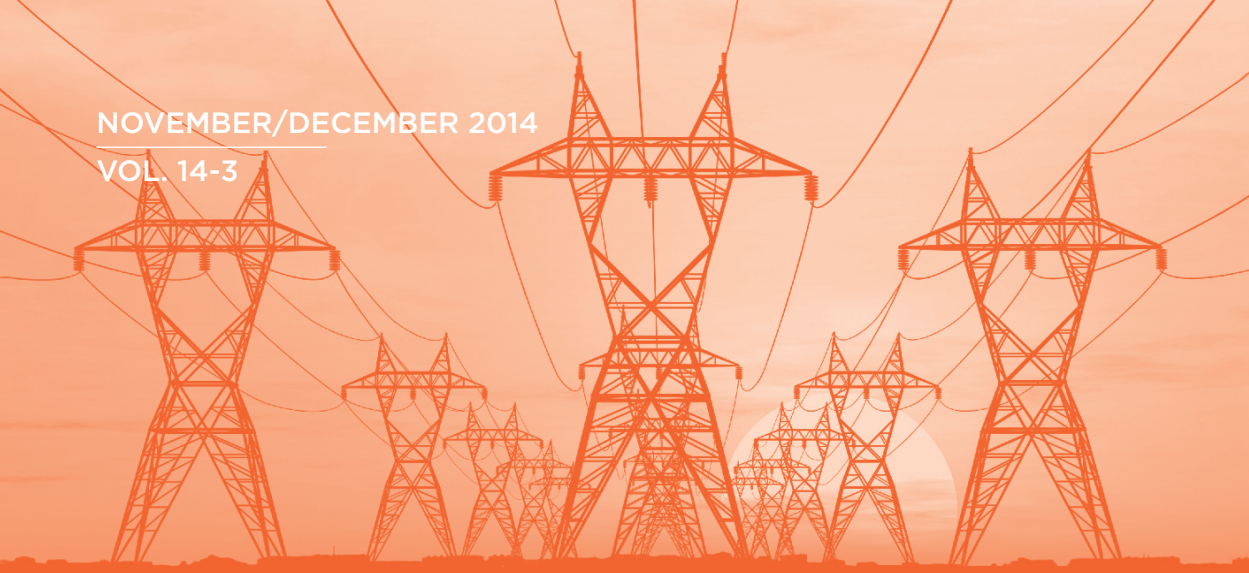
NOVEMBER/DECEMBER 2014
VOL. 14-3



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ISBN: 978-1-6328-0836-3 (print)
ISBN: 978-1-6328-0837-0 (eBook)

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S ENERGY LAW REPORT [page number] (LexisNexis A.S. Pratt);
Ian Coles, *Rare Earth Elements: Deep Sea Mining and the Law of the Sea*, 14 PRATT'S ENERGY LAW REPORT 4 (LexisNexis A.S. Pratt)

An A.S. Pratt™ Publication

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MATTHEW BENDER

(Rel.14-3–11/2014 Pub.1898)

Editor-in-Chief, Editor & Board of Editors

Pratt's Energy Law Report is published 10 times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices.

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Internal Revenue Service Issues Clarification and Modification of Beginning of Construction Rules for Purposes of the Production Tax Credit (and Investment Tax Credit in Lieu of Production Tax Credit)

By David S. Lowman, Jr., Laura Ellen Jones, Timothy L. Jacobs, and Hilary B. Lefko*

The Internal Revenue Service recently released Notice 2014-46 to clarify and modify Notice 2013-29 and Notice 2013-60, which provide guidelines for determining when construction has begun on a facility. The authors of this article discuss the Notices and the five percent safe harbor.

INTRODUCTION

Recently, the Internal Revenue Service (the "Service") released Notice 2014-46 to clarify and modify Notice 2013-29 and Notice 2013-60, which provide guidelines for determining when construction has begun on a facility. Under the American Taxpayer Relief Act of 2012 Congress extended the production tax credit ("PTCs") for wind projects until January 1, 2014, and adopted a "beginning of construction" deadline in lieu of the placed-in-service deadlines for wind, closed- and open-loop biomass, geothermal, landfill gas, trash, hydropower and marine and hydrokinetic facilities.

Notice 2014-46 further clarifies Notices 2013-29 and 2013-60 with respect to

(i) satisfaction of the physical work test and

(ii) the effect of various types of transfers with respect to a facility after construction has begun.

Notice 2014-46 also modifies the application of the five percent safe harbor.

PHYSICAL WORK TEST

Notice 2014-46 clarifies the amount of work necessary to satisfy the physical work test. Citing Notice 2013-26, the new guidance provides a nonexhaustive list of activities, which when performed alone will constitute physical work of a significant nature—the list includes excavation of the foundation for a wind turbine, the setting of anchor bolts into the ground for a wind turbine, the pouring of concrete pads for a wind turbine foundation, physical work on a customer-designed step-up transformer and construction of on-site roads for moving materials to be processed (i.e.,

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biomass) or of operations and maintenance roads. The Service clarifies "beginning work on any one of the activities described above will constitute work of a significant nature." The guidance further clarifies that there is no fixed minimum amount of work that must be performed and there is no monetary or percentage threshold required to satisfy the physical work test.

TRANSFERS WITH RESPECT TO A FACILITY

Notice 2014-46 explains that there is no statutory requirement that the taxpayer that places the facility in service also be the taxpayer that begins construction of the facility—citing Internal Revenue Code Section 48 for the proposition that "qualified property" includes property that is "constructed, reconstructed, erected, or *acquired* by the taxpayer." (Emphasis in original.) The new clarifications on transfers of facilities and equipment are similar to the anti-asset trafficking rules in Treasury's Section 1603 grant program and permit transfers of partially developed facilities (i.e., facilities that consist of more than just tangible personal property) between both related and unrelated taxpayers and permit equipment transfers between related taxpayers. Like the Section 1603 grant rules, when nothing more than tangible personal property is transferred to an unrelated person, the transferee may not rely on physical work or costs incurred by the unrelated transferor. The test to determine whether entities are related is complex, based upon the types of entities involved. In general, a partnership is related to another entity if that entity owns 20 percent or more of the capital or profit interests in such partnership.

According to Notice 2014-46, a fully or partially developed facility may be transferred without losing its qualification under the physical work test or the five percent safe harbor for purposes of the ITC or the PTC. When a taxpayer acquires a facility (that consists of more than just tangible physical property), the work performed or costs incurred by an unrelated transferor prior to January 1, 2014, may be taken into account in determining whether a facility satisfies both the physical work test and the five percent safe harbor. The Notice also expressly permits the relocation of equipment and components from an original intended site to a different site.

THE FIVE PERCENT SAFE HARBOR

The new guidance modifies the application of the five percent safe harbor by providing that a taxpayer that pays or incurs less than five percent, but more than three percent, of the costs of a multifacility project prior to January 1, 2014, may still meet the safe harbor for some, but not all, of the individual facilities, if the aggregate cost of the individual facilities at the time the project is placed in service does not exceed 20 times the amount that the taxpayer paid or incurred prior to January 1, 2014. However, if a single project cannot be separated into individual facilities, the taxpayer will not satisfy the safe harbor with respect to any portion of the facility if the taxpayer does not pay or incur five percent or more of the costs of the facility prior to January 1, 2014. An example of a multifacility project is a wind farm consisting of a number of wind turbines. An example of a single facility that cannot

be divided into separate facilities is an open-loop biomass project consisting of a single boiler and a single turbine. Failure to satisfy the modified three percent test or the five percent safe harbor will not preclude the taxpayer from qualifying under the physical work test.

While Notice 2014-46 does not explicitly address all fact patterns, the new guidance provides additional comfort in evaluating which construction activities will satisfy the physical work test and in understanding how transfers of safe harbored projects and equipment will be treated for purposes of the "beginning of construction" rules.