KPMG

What's News in Tax

Analysis that matters from Washington National Tax

IRS Extends Tax Credit Timelines for Renewable Energy Projects

June 8, 2020

by Katherine Breaks, Susan Reaman, Steven Schmoll, and Andrew Lau, Washington National Tax[*]

New renewable energy facilities are eligible for certain tax credits if construction of the facilities proceeds according to timelines designated by the IRS.[1] Covid-19 is causing construction delays for these facilities and, in response, the IRS recently issued a notice allowing taxpayers additional time to complete construction.

Notice 2020-41 extends the "Continuity Safe Harbor" (described below) for projects that began construction in either calendar year 2016 or 2017. Specifically, the IRS extended to five years the Continuity Safe Harbor for these projects. Thus, projects that began construction during calendar year 2016 have until the end of 2021 to be placed in service, and projects that began construction during calendar year 2017 have until the end of 2022.

Notice 2020-41 also provides a safe harbor for the "3½ Month Rule" (described below) for services or property paid for by the taxpayer on or after September 16, 2019, and provided by October 15, 2020.

---

* *Katherine Breaks is a principal, Susan Reaman is a director, and Steven Schmoll and Andrew Lau are senior managers with the Tax-Incentivized Transactions, Leasing, and Energy group of Washington National Tax.*

1 See IRS Notice 2013-29, clarified by Notice 2013-60; Notice 2014-46; Notice 2015-25; Notice 2016-31; and Notice 2017-4, and Notice 2018-59.

Background

Renewable energy incentives include the investment tax credit (the "ITC") under section 48[2] and the renewable electricity production tax credit under section 45 (the "PTC").

To qualify for the PTC, electricity must be produced by the taxpayer at a qualified facility defined in section 45(d).[3] Alternatively, the taxpayer may elect to claim the ITC in lieu of the PTC in connection with a facility that otherwise qualifies under section 45(d).

Each of the ITC and the PTC have a beginning of construction requirement. In Notice 2013-29 and subsequent notices, the IRS prescribed two methods for beginning construction: the "Physical Work Test" and the "Five Percent Safe Harbor." Taxpayers that rely on the Physical Work Test must pursue a continuous program of construction once construction has begun. Taxpayers that rely on the Five Percent Safe Harbor must pursue continuous efforts toward completion of construction once construction has begun. These tests are often referred to collectively as the "Continuity Requirement."[4]

Whether the Continuity Requirement is satisfied depends on the relevant facts and circumstances. Notably, the IRS has provided a safe harbor for the Continuity Requirement (the Continuity Safe Harbor) that allows a facility to be deemed to have satisfied the Continuity Requirement if a taxpayer places a facility in service by the later of (1) a calendar year that is no more than four calendar years after the calendar year during which construction of the facility began or (2) December 31, 2018.

Extension of the Continuity Safe Harbor

Notice 2020-41 provides that for projects that began construction in either calendar year 2016 or 2017 under the Physical Work Test or the Five Percent Safe Harbor, the Continuity Safe Harbor is met if a taxpayer places the project in service by the end of a calendar year that is no more than *five* calendar years after the calendar year when construction began.[5] Thus, projects that began construction in 2016 have until the end of 2021 to be placed in service, and 2017 projects have until the end of 2022.

The extension relief is provided not only for projects that started in 2016, but also for projects that started in 2017. This is helpful for the 2017 projects as it is not yet clear how long disruptions in the development of renewable energy facilities may last. Although the relief granted by Notice 2020-41 comes in response to project delays resulting from the Covid-19 pandemic, application of the extension

---

2 Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

3 Section 48(a)(2)(A)(ii).

4 For additional insights on beginning of construction and the Continuity Requirement, see Jason Dexter, Jaime Park, Katherine Breaks, and Rich Blumenreich, "IRS Notice 2016-31: Further Clarification of 'Begin Construction' for Renewable Energy Facilities," Bloomberg BNA Daily Tax Report, 184 DTR J-1, (Sept. 22, 2016) and Susan Reaman and Katherine Breaks, "Beginning of Construction for the Section 48 Investment Tax Credit," What's News in Tax (Oct. 8, 2018) available at https://home.kpmg/content/dam/kpmg/us/pdf/2018/10/tnf-wnit418-oct8-2018.pdf.

5 Sec. 3 of Notice 2020-41.

does not require the taxpayer to prove that delays were related to the Covid-19 pandemic. Further, it appears that so long as other requirements in Notice 2020-41 are satisfied, the extension applies automatically.

Safe Harbor for 3½ Month Rule

The Five Percent Safe Harbor is satisfied if the taxpayer pays or incurs at least five percent of total eligible (or integral) project costs by the “begin construction” deadline. For accrual method taxpayers, amounts are accrued as services or property are provided to the taxpayer.[6] In general, property is provided when title passes, or delivery is made or accepted, depending on the taxpayer’s method of accounting.[7]

If permissible under the taxpayer’s method of accounting, a taxpayer may treat services or property as provided to the taxpayer as the taxpayer makes payment to the person providing the services or property if the taxpayer can reasonably expect the person to provide the services or property within 3½ months after the date of payment (the “3½ Month Rule”).[8]

Whether a particular taxpayer has a reasonable expectation at the time of payment that the property or services will be provided within 3½ months can be a subjective determination.

To provide more certainty and assurance to renewable energy developers that are experiencing construction and procurement delays, Notice 2020-41 provides a new safe harbor under the 3½ Month Rule. For payments made after September 15, 2020, the taxpayer will be deemed to have had a reasonable expectation that the services or property would be provided within 3½ months after the date of payment, if the services or property are actually provided to the taxpayer by October 15, 2020.[9]

Although the safe harbor for the 3½ Month Rule will not apply to any services or property received by a taxpayer after October 15, 2020, the 3½ Month Rule may still be satisfied based on a taxpayer’s particular facts and circumstance. The safe harbor for the 3½ Month Rule applies only for purposes of the beginning of construction requirements for the PTC and the ITC under Notice 2020-41.[10]

As with the Continuity Safe Harbor, the safe harbor for 3½ Month Rule applies regardless of whether the taxpayer is actually affected by the Covid-19 pandemic. This safe harbor provides needed relief to many renewable energy developers that were worried they could not meet the existing rules with the level of certainty needed to complete their projects and qualify for the anticipated tax credits. Deliveries that take place after October 15, 2020, will continue to be analyzed under all the facts and circumstances.

---

[6] Section 1.461-4(d)(2)(i)

[7] Section 1.461-4(d)(6)(iii)

[8] Section 1.461-4(d)(6)(ii)

[9] Sec. 4 of Notice 2020-41.

[10] *Id.*