New Budget Proposal Could Mean Sweeping Changes in Wind Energy Tax Credits

The IRS provided new guidance in an April 15, 2013 notice (the "Notice") relating to the commencement of construction requirement for renewable energy projects eligible for either of two targeted tax credits.[1] Additionally, the Obama administration's 2014 fiscal year budget proposal (the "Budget Proposal"), if enacted, would significantly alter the landscape for renewable energy developers and investors.

Notice 2013-29

Wind facilities are eligible under current law for either, at the taxpayer's election, (i) a production tax credit ("PTC"), generally equal to 2.3 cents per kWh of electricity produced and sold to a third party, or (ii) an investment tax credit ("ITC"), generally equal to a percentage of the qualified costs incurred in constructing the facility. The PTC and ITC are only available for facilities "the construction of which begins before January 1, 2014."[2] The Notice provides helpful guidance on what constitutes the beginning of construction for this purpose as well as a developer-friendly safe harbor, drawing upon rules similar to those of the stimulus "cash grant" program under Section 1603 of the American Recovery and Reinvestment Act of 2009.

Under the Notice, construction begins in a given year either (1) when "physical work of a significant nature" begins, based on all facts and circumstances,[3] or (2) under a safe harbor provision (the "Safe Harbor"), when a taxpayer pays or incurs five percent or more of the total cost of the facility.[4] Under both tests, taxpayers may take into account costs incurred by the taxpayer under a binding written contract with a third party, including all costs related to (a) "functionally interdependent" components of a facility and (b) multiple facilities that are operated as part of a single project.[5] A developer is also required under each test to meet certain construction continuity requirements after 2013 on a facility in order to "begin construction" on that facility in 2013 for PTC and ITC purposes.[6]

Finally, if a taxpayer fails the Safe Harbor for a project composed of multiple facilities due to cost overruns after December 31, 2013, the Notice provides that the taxpayer may still claim the PTC or ITC for individual facilities within the project (but not for the project as a whole) if the taxpayer meets the Safe Harbor for those individual facilities (i.e., if the total costs incurred before January 1, 2014 are 5 percent or more of the total costs incurred for those individual facilities).[7]

Obama Budget Proposal Provisions on Renewable Energy

The Budget Proposal, if enacted into law, would make several significant changes to the current regime described above:

- The PTC and ITC have repeatedly expired and been re-authorized in prior years and are currently available only for wind projects that begin construction before January 1, 2014. The Budget Proposal would make the PTC (but not the ITC) a permanent provision of the Code (so that the PTC would be available in the future without regard to any placed-in-service or commencement-of-construction deadlines). Without additional legislation, the ITC will no longer be available for wind projects on which construction begins after December 31, 2013.

- Additionally, the Budget Proposal would make the PTC refundable for projects on which construction begins after December 31, 2013 — any amount of the PTC a taxpayer could claim that exceeds the taxpayer's tax liability in a given year would simply be paid in cash to the taxpayer.

- Finally, the Budget Proposal would authorize an additional $2.5 billion of tax credits for investments in certain qualifying advanced energy manufacturing projects, such as manufacturing facilities for wind turbines, fuel cells and other advanced energy property.

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1 Notice 2013-29, I.R.B. 2013-20 (April 15, 2013).

2 Internal Revenue Code (the "Code") Sections 45(d), 48(a)(5). Previously, the credits were available only for wind facilities that were placed in service prior to January 1, 2013. Legislation in 2012 extended the credits and changed the placed-in-service standard to a commencement-of-construction standard.

3 The IRS will look to both on-site and off-site work for this purpose, and the Notice includes a number of examples of what will and will not constitute "physical work of a significant nature." For example, physical work of a significant nature begins with "the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of concrete pads of the foundation." Notice 2013-29 at Section 4.01.

4 *Id.* at Section 5.01.

5 "Functionally interdependent" components of a facility generally include all components that are integral to the generation of electricity at a facility, which in the wind energy context would include the wind turbine, its tower, and its supporting pad, but not transmission lines, access roads, fencing, and most buildings. *Id.* at Sections 4.04, 4.05. Under the Notice, factors indicating that multiple facilities are part of a single project include (i) ownership by a single entity, (ii) construction on contiguous pieces of land, (iii) a common power purchase agreement, intertie and substation, and (iv) shared regulatory permits, construction contracts, and loan agreements. *Id.* at Section 4.04(2).

6 *Id.* at Section 4.06. The standards for continuity are slightly different under each test. While the first test requires "continuous physical work of a significant nature," the Safe Harbor test merely considers physical work of a significant nature as a factor. *Id.* at Sections 4.02, 4.06, 5.02. Additionally, the Safe Harbor continuity requirement takes into account certain preliminary and nonphysical work that the first test does not. *Id.* at 4.02(1), 4.06, 5.02(1). Also, the Notice states that under either test, certain disruptions beyond the taxpayer's control, such as severe weather, natural disasters, and permitting delays, do not cause a taxpayer to fail to maintain a continuous program of construction. *Id.* at Section 4.06(2), 5.02(2).

7 *Id.* at Section 5.03(1).

If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

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