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Blog Post

# IRS Relaxes Tax Credit Qualification Rules for Renewable Energy Projects Located Offshore or on Federal Land

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*This post has been updated to reflect changes in the officially published version of IRS Notice 2021-05.*

IRS guidance released on December 31, 2020, makes it easier for developers of renewable energy projects located offshore or on federal land to qualify for tax credits by giving them an extended 10-year runway to place the projects in service after construction begins. Prior guidance required such projects to be placed in service within four years after the year in which construction began unless the developer could show that it continuously incurred costs and/or performed physical work on a project throughout the construction period. The extension provides welcome certainty to developers of large-scale projects offshore or on federal lands, particularly offshore wind projects that have been facing permitting and other delays and were pushing up against a four-year deadline. The guidance is in IRS Notice 2021-05.

## Background – Tax Credit Qualification and Continuity Safe Harbor

Most U.S. renewable energy projects qualify for federal income tax credits which, depending on the asset class, are based on either how much the project costs to build (i.e., investment tax credits) or how much energy is produced and sold in a given year (i.e., production tax credits). The value of both investment tax credits

and production tax credits depend on the year in which the underlying project begins construction.

The IRS has now issued 10 separate sets of published guidance since 2013 providing rules for when construction begins. At a high level, construction begins in the year in which the developer commences physical work of a significant nature or incurs at least five percent of the total project cost. Once construction begins, however, the rules require the developer to make continuous progress towards completion. The problem is that large scale projects that are developed over multiple years often encounter unexpected regulatory, construction, financing or other delays, and it may be hard to show continuous progress. In order to help these projects qualify, the IRS created a "Continuity Safe Harbor" under which work is deemed to be continuous as long as a project is placed in service within four years after the year in which construction begins. Unfortunately it is more difficult for projects that fall outside of the Continuity Safe Harbor to secure tax equity or debt financing because of the added uncertainty involved in determining whether progress was "continuous."

The Taxpayer Certainty and Disaster Tax Relief Act of 2020 (enacted as part of the Consolidated Appropriations Act, 2021), which was signed by President Trump on December 27, 2020, extended the beginning of construction deadlines for many types of renewables projects. A summary of the extensions and a brief overview of the related tax credits and credit rates is available here. Offshore wind projects now qualify for an investment tax credit worth 30% of a project's cost if construction begins before 2026. Offshore Projects and Federal Land Projects (defined below) are both technically eligible for either investment tax credits or production tax credits.

## Scope of IRS Notice

IRS Notice 2021-05 extends the Continuity Safe Harbor deadline — from four years to 10 — for "Offshore Projects" and "Federal Land Projects."

Offshore Projects include renewable energy projects that will be placed in service in any inland navigable waters or coastal waters of the U.S.[1]

Federal Land Projects include renewable energy projects, more than 50% of which

will be placed in service on land owned or controlled by the U.S., and that will require the construction of one or more high-voltage transmission lines to connect to the electrical grid.

The notice does not change the Continuity Safe Harbor deadline for any other types of facilities. The IRS explained that it granted special relief for Offshore Projects and Federal Land Projects because those projects experience complicated ordinary-course delays from factors such as (i) significantly more stringent permitting requirements, (ii) lengthier engineering and construction timelines, (iii) heightened environmental regulation and (iv) the need to construct new transmission lines, and that such delays can result in project completion times of up to twice as long as projects that are not constructed offshore or on federal land.

Projects that do not need meet the Continuity Safe Harbor deadlines can still qualify for tax credits if the facts and circumstance show continuous progress. However, as noted above, finding tax equity or debt financing for projects outside of the Continuity Safe Harbor can be challenging.

## Looking Ahead

The end of 2020 was particularly good to offshore wind project developers. Offshore wind projects now qualify for a 30% investment tax credit if construction begins before 2026, and they should have an easier time securing tax equity and debt financing in light of the new 10-year placement in service runway. Developers of other types of renewables projects also benefitted from the tax credit extensions. With renewables appearing set for another big year in 2021, one question mark continues to be whether tax equity supply will improve in 2021 for developers who had trouble accessing the market in 2020, or if there will continue to be market supply issues. As discussed in more detail here, a direct pay or refundable tax credit option was a potential solution to lagging tax equity supply that ultimately did not make it into the final coronavirus relief legislation.

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1. The advance version of IRS Notice 2021-05 released on December 31, 2020, also required Offshore Projects to include the construction of high-voltage transmission lines to connect to the electrical grid. This requirement was dropped in the final version of the notice that was published in the Federal Register on January 19, 2021. It

remains a requirement for Federal Land Projects.↩

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