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IRS Comments on its PTC Start of Construction Guidance

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Reading Time : **5 min**

Below are highlights of Mr. Kelley's remarks. Many remarks provide helpful clarifications of the rules or insight into the policy rationales for the rules. This post was prepared without the benefit of a transcript or a recording. Please feel free to contact the author to request corrections. Also, it is important to note that these remarks were informal and are not binding on the IRS.

As background, Notice 2014-46 primarily clarified three points:

1. For projects that did not meet the safe harbor of spending 5 percent of their cost in 2013 and instead undertook "significant physical work" in 2013, there is no minimum threshold of work required as long as the work performed in 2013 was **significant** as provided for in the IRS notices.

2. Transfers of grandfathered projects are permissible, as long as either (a) the transfer includes contracts or land rights or (b) the transferee and transferor are more than 20 percent related.

3. If a project fell short of the 5 percent safe harbor, but at least 3 percent was spent in 2013, then the number of turbines included in the project that are tax-credit-eligible may be prorated accordingly.

Significant Physical Work

Mr. Kelley confirmed that the wind industry's reading of the physical work requirement in Notice 2014-46 was accurate: "The significant physical work standard is a qualitative standard, rather than quantitative. There is no minimum amount of work that must have been done in

2013. There is no bright line. The test is somewhat nebulous. A lot of the test comes from the 1603 start of construction FAQs, bonus depreciation rules and investment tax credit rules going back to the 1960s."

Mr. Kelley was asked if the level of "physical work" required increased proportionately with the size of the project. He responded, "The size of the project does not matter. The work must be **significant** and done in 2013."

Mr. Kelley was asked if excavating a single turbine site was sufficient. He responded, "I don't want to speculate about specific fact patterns. You get some comfort from the language in the two notices."

Mr. Kelley was asked if it was necessary to excavate, pour concrete **and** install bolts for one or more turbine sites in 2013 to achieve significant physical work in 2013. He said, "It is fair reading that just starting excavation is enough without pouring concrete or installing bolts. The language says 'or,' rather than 'and.'[1] Any one activity is sufficient."

Mr. Kelley was asked if "excavation has begun," if, at the end of 2013, a project owner started excavating a turbine site but did not "finish off" the excavation due to the pending winter being likely to damage the finishing work. His response was "sounds like excavation has begun and is significant."

Mr. Kelley was asked why examples were not included in Notice 2104-46. He said, "Additional examples might perhaps cause more confusion than they help."

No Binding Written Contract Requirement for On-Site Work

Mr. Kelley was asked if a "binding written contract" was required for physical work that was conducted on the project site. After an apparent sidebar with his IRS colleagues, he responded, "I don't think so if the work is done on site and is **significant**." This interpretation is helpful because section 4.02 of Notice 2013-29 provides, "Both on-site and off-site work (performed either by the taxpayer or by another person under a binding written contract) may be taken into account for purposes of demonstrating that physical work of a significant nature has begun." Based on Mr. Kelley's comment, the parenthetical clause is intended to only modify "off-site work."

Changes in the Location of the Project in Which Safe Harbored Equipment Will Be Used

Mr. Kelley was asked whether, if a developer has a master turbine contract with a manufacturer that was entered into 2013 and the 5 percent cost was incurred under that contract in 2013, the five percent safe harbor was met even if the developer did not know at what project site the turbines would be deployed. He responded, "You do not have to know the address of the project in 2013. That's the point of the relocation provision of the notice."[2]

He added that it is permissible to have purchased equipment for the 5 percent safe harbor and had "multiple projects in mind" for the same equipment. Further, he was asked if the reference in section 4.03 of Notice 2014-46 to a "taxpayer also may begin construction of a facility in 2013 with the intent to develop the facility at a **certain site**" requires a developer to be able to demonstrate that, in 2013, it had an intent to develop a particular site. His response was that the reference did not require that.

Transfers

Mr. Kelley made it clear that it is possible for one taxpayer to transfer only safe harbored equipment to a transferee that is more than 20 percent related to the transferor. The transferee can then undertake additional development work, such as obtaining land rights, permits, interconnection agreements or a power purchase agreement and then transfer the safe-harbored equipment plus those rights or agreements to an unrelated party. That unrelated party could then claim tax credits based on its ownership of the safe-harbored equipment.

Mr. Kelley was asked for detail with respect to the requirement in section 4.03 of Notice 2014-46 that a transfer to an unrelated party include more than merely "tangible personal property" (i.e., equipment). He replied, "The right way to look at it is to include land, a land lease, a power purchase agreement or an interconnection agreement. This rule is following the 1603 start of construction FAQs."

The "master contract" rules in section 4.03(2) of Notice 2013-29 refer to transferring safe-harbored equipment to "an affiliated special-purpose vehicle." Mr. Kelley was asked what the relationship is between "an affiliated special-purpose vehicle" and the 20-percent-related party standard with respect to transferees in section 4.03 of Notice 2014-46. He responded,

"The affiliated special-purpose vehicle language is borrowed from the 1603 start of construction FAQs. I don't have a comment on how to tie it to the related party rules."

Three Percent Standard for Prorating Tax Credits

Mr. Kelley was asked for the policy rationale for including section 5.01 of Notice 2014-46 that provides rules with respect to projects that are unable to meet either (a) the 5 percent spend in 2013 safe harbor or (b) the significant physical work requirement but for which at least 3 percent was spent in 2013. He noted that some project owners had explained to the IRS that they were building extremely large projects for which the 5 percent spend was not feasible; however, for reasons he did not specify, the projects were unable to meet the significant physical work standard. He explained that the government was persuaded that it was unreasonably harsh for such projects to be eligible for zero tax credits while a project for which "excavation of a single turbine site" occurred in 2013 would be eligible for full tax credits under the significant physical work standard. Thus, the IRS made a "policy call to provide some relief but put in a three percent floor."

A tangential ramification of this statement is that Mr. Kelley appears to have implicitly endorsed excavating a single turbine site as being sufficient for the start of significant physical work, although he sidestepped that question the first time it was asked.

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[1] *See Notice 2014-46,* § 3; Notice 2013-29, § 4.02.

[2] *See* Notice 2014-46, § 4.02.

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