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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

IRS Extension Is Partial Relief For Renewable Energy Projects

By **David Burton** (July 1, 2021, 5:01 PM EDT)

David Burton

The Internal Revenue Service's June 29 Notice 2021-41 has provided certain relief under the start-of-construction rules for wind and solar projects.

Projects that started construction from 2016 to 2019 now have six years to be completed and retain their start-of-construction vintage, while projects that started construction in 2020 continue to have five years to be completed.

The completion deadline issue dates back to 2013. In the original start-of-construction guidance, provided in Notice 2013-29, once a taxpayer started construction it was obligated to pursue the process continuously until completion of the project.

Taxpayers complained that the continuous standard was too subjective, and that law firms would struggle to render the level of opinion on it required by financiers. In Notice 2013-60, the IRS created the so-called deemed continuity rule, which provided a project would be deemed to have satisfied the continuous requirement so long as it was completed before Jan. 1, 2016.

In response to legislative extensions of the begun construction deadlines, the deemed continuity rule was extended by the IRS. In Notice 2016-31, the IRS created a more generic deadline that would not need to be updated each time there was a legislative extension of the credit — Dec. 31 of the year that contains the fourth anniversary of when the project began construction.

That rule stood until May 2020 when, in response to disruptions in the global supply chain and restrictions on the work of construction crews the IRS issued Notice 2020-41 extending the deemed continuity rule to the fifth anniversary. This was only for projects on which construction started in 2016 or 2017.

Due to continued delays caused by the repercussions of COVID-19, the IRS has granted another year of relief for projects that started construction between 2016 and 2019, which now have six years.

The Statutory Constraint on Solar

Unlike wind, solar projects have a statutory deadline: To qualify for more than a 10% investment tax

credit, solar projects must be in service before the end of 2025. Only Congress can change that statutory deadline.

For solar projects that started construction in 2019, 2020 or 2021 the period for the deemed continuity rule now matches the statutory deadline: six years for 2019 vintage projects, five years for 2020 vintage projects and four years for 2021 vintage projects.

However, a solar project that starts construction in 2022 or 2023 would have to be in service by the end of 2025 to qualify for more than a 10% investment tax credit, despite having four years under the deemed continuity rule.

Under Notice 2021-41, a wind project that started construction in 2016 has to be complete by Dec. 31, 2022, to qualify for a $25 per megawatt hour production tax credit for its first 10 years of operations. Similarly, under the notice a solar project that started construction in 2019 has to be complete by Dec. 31, 2025, which is the same deadline that applies under the statutory deadline for a solar project to be eligible for more than a 10% investment tax credit.

It is not clear why Congress determined it necessary to provide solar, but not wind, with a placed-in-service deadline. It could be related to the fact that solar has a 10% permanent investment tax credit that is not subject to any of these deadlines, while there is no permanent tax credit for wind.

The extension in this most recent notice does not alter the generous extension of the deemed continuity rule that the IRS provided in Notice 2021-5, issued in January, to (1) projects on federal land that require high-voltage transmission lines to be constructed and (2) offshore wind projects. The January notice provided such projects with a deadline to be completed until Dec. 31 of the calendar year that contains the 10th anniversary of when such project started construction.

That relief is of less value for solar projects than wind projects, due to the statutory placed-in-service deadline for solar.

The Solar Energy Industry Association, in an April 12 letter to U.S. Treasury Secretary Janet Yellen, advocated for the extension of the IRS administrative continuity safe harbor in Notice 2021-41, in part because some solar companies were concerned about the qualification of projects that they had been pursuing for years.

The assurance in Notice 2021-41 is that a project that requires six years to complete will be protected from an IRS auditor asserting that the project failed the deemed continuity rule: For instance, if a project is placed in service in 2023, under the prior guidance an IRS auditor could try to assert that the project in fact started construction in 2017 — i.e., more than five years before the placed-in-service year under the prior deadline for the deemed continuity rule — due to activity in 2017 at the project site or work off-site on a custom component for the project, and accordingly failed the deemed-continuity rule.

Accordingly, solar developers that started working on solar projects before 2020 now have up to six years to finish them without concern about an IRS foot fault.

Relaxed Continuity Standard

The new IRS notice also provides certain relief for projects that exceed the applicable six-, five- or 10-year period to meet the deemed continuity rule.

To satisfy the IRS guidance, such projects had to be able to prove actual continuous progress. The nature of the progress that had to be proven was different if the project had satisfied the so-called 5% safe harbor, by incurring at least 5% of the total cost of the project in the applicable vintage year versus projects that started onsite or offsite significant physical work in the applicable vintage year.

The 5% safe harbor projects had to prove only continuous efforts, while the physical work projects had to prove continuous construction. The difference being that continuous efforts included paying certain amounts, entering into contracts and applying for permits, while continuous construction required activity in the nature of physical labor.

Under the new guidance, the IRS allows taxpayers to select either continuous efforts or continuous work. The continuous efforts standard includes all activity that would qualify under continuous construction, so effectively the IRS has created a uniform standard of continuous efforts.

The New Notice Defers an Awkward Question

The IRS has yet to publish an answer to the question of what tax credit a project qualifies for if it exceeds the applicable deemed continuity rule and cannot prove that work on the project was continuous. Some fear that the IRS could assert the project qualifies for no tax credit. However, such a result seems like it would be overly harsh.

It seems consistent with statutory interpretation principles that the project should be able to at least qualify for a tax credit based on what tax credit would be available to it under the applicable statute if the year the project was placed in service was the same year the project began construction — i.e., it clearly began construction no later than the year it was placed in service.

The tax credit statutes merely refer to when the project began construction and not all the mumbo jumbo in the IRS notices, which were issued at the request of taxpayers seeking certainty as to technical issues but cannot alter to a taxpayer's detriment the plain meaning of the statute.

After Notice 2021-41, this question is deferred until 2023. For instance, if an onshore wind project started construction in 2016 using the 5% safe harbor, is unable to prove continuous efforts from 2016 until 2021, and is placed in service in January 2023 — i.e., beyond the six-year period for a 2016 vintage project — what level of production tax credit does the project qualify for?

Is the answer none, due to the project's failing the continuity requirement? Or can the project's owner assert that the project only began construction, under the plain meaning of that statutory phrase, in 2021, when the cranes and hardhats started working, and therefore the project should qualify for a $15 production tax credit due to having begun construction after Dec. 31, 2019, and before Jan. 1, 2022 — i.e., the taxpayer loses the full credit of $25 per megawatt hour but can call fallback to 60% of that amount?

Such an argument would be based on the principle that the IRS can announce in a notice that it will apply a statutory rule in a more taxpayer-friendly manner than the plain meaning of that rule, but it cannot alter the plaining meaning of a statutory rule to taxpayers determent by issuing a notice. However, this most recent notice leaves open whether the IRS will allow a tax credit if a project exceeds the deemed continuity rule and cannot prove continuous work.

David Burton is a partner at Norton Rose Fulbright.

Disclosure: The author is a member of the Solar Energy Industry Association and was involved in drafting the letter discussed in this article.