




2018 Deloitte Renewable Energy Seminar

Scaling new heights

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Energy Solutions



Understanding the
details of beginning
of construction
standard and recent
tax controversy
trends

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Investment Tax Credit (“ITC”) and Production Tax Credit (“PTC”)

Current Landscape

Investment Tax Credit - timing

Type of Energy Property	Date Construction Begins	Placed in Service Date	ITC Amount
Solar	Before 1/1/2020	Before 1/1/2024	30%
	Calendar 2020	Before 1/1/24	26%
	Calendar 2021	Before 1/1/24	22%
	Before 1/1/22	On or after 1/1/24	10%
	On or after 1/1/22	Any	10%
Fiber-Optic Solar	Before 1/1/20	Before 1/1/24	30%
	Calendar 2020	Before 1/1/24	26%
	Calendar 2021	Before 1/1/24	22%
	Before 1/1/22	On or after 1/1/24	0%
	On or after 1/1/22	N/A	0%
Qualified Fuel Cell	Before 1/1/20	Before 1/1/24	30%
	Calendar 2020	Before 1/1/24	26%
	Calendar 2021	Before 1/1/24	22%
	Before 1/1/22	On or after 1/1/24	0%
	On or after 1/1/22	N/A	0%

Investment Tax Credit - timing

Type of Energy Property	Date Construction Begins	Placed in Service Date	ITC Amount
Qualified Small Wind	Before 1/1/2020	Before 1/1/2024	30%
	Calendar 2020	Before 1/1/24	26%
	Calendar 2021	Before 1/1/24	22%
	Before 1/1/22	On or after 1/1/24	0%
	On or after 1/1/22	N/A	0%
Qualified Microturbine	Before 1/1/22	Any	10%
	On or after 1/1/22	N/A	0%
Combined Heat and Power (CHP)	Before 1/1/22	Any	10%
	On or after 1/1/22	N/A	0%
Geothermal Heat Pump	Before 1/1/22	Any	10%
	On or After 1/1/22	N/A	0%
Geothermal	Any	Any	10%

Production Tax Credit and ITC in lieu of PTC

Qualified Resources/Facilities	Credit Amount for 2018	Construction Beginning...	Phase-out (PTC Amount)	30% ITC Election
Wind	2.4 cents/kwh	Before 1/1/2017	100%	30%
		Calendar 2017	80%	24%
		Calendar 2018	60%	18%
		Calendar 2019	40%	12%
Geothermal	2.4 cents/kwh	Before 1/1/2018	None	30%
Closed-loop biomass	2.4 cents/kwh	Before 1/1/2018	None	30%
Open-loop biomass	1.2 cent/kwh	Before 1/1/2018	None	30%
Municipal solid waste (landfill gas, trash)	1.2 cent/kwh	Before 1/1/2018	None	30%
Hydropower	1.2 cent/kwh	Before 1/1/2018	None	30%
Marine and hydrokinetic renewables (including small irrigation power)	1.2 cent/kwh	Before 1/1/2018	None	30%

Overall Comparison of PTC and ITC

	PTC	ITC
Amount	2.4 cents (or 1.2 cents) per kWh	One-time tax credit (30% or 10% of eligible basis)
Timing	10-year credit period for qualified resources	One-time (placed in service date)
Specific Restrictions	<ul style="list-style-type: none"> • Credit reduction for subsidized or tax-exempt financing • Third-party sales requirement • Ownership requirement • No basis reduction in property 	<ul style="list-style-type: none"> • No credit reduction for subsidized or tax-exempt financing after 12/31/08 • No third-party sales requirement • Original use only; no ownership requirement • 50% of ITC basis reduction of property • Tax-exempt use prohibition • Normalization required
Recapture	No Recapture	Five year recapture period
Structure	<ul style="list-style-type: none"> • Flip 	<ul style="list-style-type: none"> • Flip • Sale-Leaseback • Capital Lease • Lease Pass-Through



PTC begun construction rules

Begun construction background

- Under current law, a taxpayer may claim 100 percent of the value of PTCs or the ITC in lieu of PTC on a new qualified wind facility only if construction of the facility began (the begun construction requirement) **before January 1, 2017.**
 - The credit amount thereafter phases down by 20 percent each year and phases out for facilities that do not begin construction before January 1, 2020
- American Taxpayer Relief Act of 2012 was enacted January 2, 2013
 - Changed eligibility for certain PTC and ITC in lieu of PTC technologies from a “placed-in-service” date requirement to a requirement that a facility must have “begun construction” before January 1, 2014
 - Based on recent American Recovery and Reinvestment Act section 1603 Treasury Grant Program implementation
- Taxpayer Increase Prevention Act enacted on December 19, 2014 extended PTC and ITC in lieu of PTC for facilities that had begun construction before January 1, 2015
- Protecting American from Tax Hikes Act of 2015 (PATH Act) and Consolidated Appropriations Act of 2015 (together “tax extenders”) enacted on December 18, 2015, provided the current long term extension and phase out for the wind PTC and solar ITC
- Bipartisan Budget Act of 2018, enacted in February, retroactively extended the PTC and ITC for non-wind and non-solar property

Begun construction background

- To satisfy the begun construction requirement, IRS guidance requires that the taxpayer prove that prior to the statutory credit deadline, it commenced “physical work of a significant nature” on the facility (physical work test) or incurred at least five percent of the total cost of the facility (Five Percent Safe Harbor).
- Thereafter, and until the facility is placed in service, the taxpayer must also prove that it maintained a “continuous program of construction” to satisfy the physical work test or made “continuous efforts to advance towards completion of the facility” to satisfy the Five Percent Safe Harbor (collectively, the Continuity Requirement).
 - A taxpayer was previously deemed to satisfy the Continuity Requirement if a project was placed in service within two years of the begun construction deadline
 - Recent IRS guidance provides that the continuity requirement is deemed satisfied if a project is placed in service within four years of the end of the calendar year in which construction begins (Continuity Safe Harbor)

Common strategies for beginning construction on wind projects

Example 1: Purchase Turbines

Taxpayer is developing a 300 MW wind project with a total capex of \$400 million. The wind project is slated to have 100 turbines. Taxpayer enters into a turbine supply agreement with Manufacturer to acquire 10 wind turbines at a cost of \$25 million. The turbine supply agreement is executed on December 1, 2016, and requires all turbine components (e.g., tower, nacelle, and blades) to be completed with title transferring to the Taxpayer by April 15, 2017. Taxpayer is on the accrual method of accounting and makes payment of the \$25 million purchase price on December 31, 2016.

Has Taxpayer Begun Construction for purposes of the PTC?

YES!

- 5% Safe-Harbor / continuous efforts to advance toward completion
- Economic performance and the 3 ½ month rule
- Cost overrun rule
- Tax ownership of turbine components
- Permissible transfers

Example 2: On-Site Physical Work

Taxpayer is developing a 300 MW wind project with a total capex of \$400 million. The wind project is slated to have 100 turbines. Taxpayer has leased land rights and developed an initial site design. On December 1, 2016, Taxpayer enters into an agreement with Contractor to begin on-site physical construction through the excavation of ten wind turbine foundations. Before the end of 2016, Contractor begins work on a single wind turbine foundation ("Foundation #1") and by starting to build a road between Foundation #1 and another planned wind turbine foundation ("Foundation #2") for purposes of operating and maintaining the wind turbines once placed in service. Contractor's excavates and lays the mud mat for the single turbine foundation before January 1, 2017 at a cost of \$50,000, and then completes the excavation and laying of the mud mats for the remaining nine turbine foundations pursuant to the agreement in early 2017. Contractor's work on the road in 2016 included clearing the land, building embankments using cuts and fills, leveling the dirt and bumps, and placing gravel on the road bed at a cost of an additional \$50,000.

Has Taxpayer Begun Construction for purposes of the PTC?

YES!

- Physical work of a significant nature / continuous program of construction
- How much physical work is enough?
- Permissible transfers

Example 3: Off-Site Physical Work

Taxpayer is developing a 300 MW wind project with a total capex of \$400 million. The wind project is slated to have 100 turbines. On December 1, 2016, Taxpayer enters into a binding written contract with Manufacturer, to purchase a custom-designed step-up transformer. The total transformer purchase price is \$1,900,000. The contract includes a penalty of 5% of the purchase price if cancelled/terminated. The initial down payment is \$100,000 which is paid in 2016 upon execution of the purchase order. Manufacturer fabricates a radiator tank, a component of the transformer not commonly held in inventory. This component has a serial number, was not previously held in inventory and was manufactured after execution of the contract for the specific custom-designed transformer that will be incorporated into the wind project.

Has Taxpayer Begun Construction for purposes of the PTC?

YES!

- Physical work of a significant nature / continuous program of construction
- How much physical work is enough?
- Inventory rule
- Permissible transfers

Five Percent Safe Harbor

Notice 2013-29

- Issued April 15, 2013
- “Construction of a facility will be considered as having begun before January 1, 2014, if (1) a taxpayer **pays or incurs** (within the meaning of Treas. Reg. § 1.461-1(a)(1) and (2)) five percent or more of the total cost of the facility, except as provided in section 5.01(2), before January 1, 2014, and (2) **thereafter**, the taxpayer makes continuous efforts to advance towards completion of the facility (as determined under section 5.02).”
 - “Incurring” costs vs. making payment
 - Economic performance through delivery or transfer of tax ownership
 - 3.5-month rule exception
 - Method of accounting
 - Look-through rule for work performed under a binding written contract:
 - “for property that is manufactured, constructed, or produced for the taxpayer by another person under a binding written contract with the taxpayer, costs incurred with respect to the property by the other person before the property is provided to the taxpayer are deemed incurred by the taxpayer when the costs are incurred by the other person under the principles of section 461.”

Notice 2013-29

- Continuous efforts toward completion

- Facts and circumstances indicating continuous efforts to advance towards completion of the facility may include, but are not limited to:

- (a) paying or incurring additional amounts included in the total cost of the facility;
 - (b) entering into binding written contracts for components or future work on construction of the facility;
 - (c) obtaining necessary permits; and
 - (d) performing physical work of a significant nature (as described in section 4.02)

- Excusable disruptions

- (a) severe weather conditions; (b) natural disasters; (c) licensing and permitting delays; (d) delays at the written request of a state or federal agency regarding matters of safety, security, or similar concerns; (e) labor stoppages; (f) inability to obtain specialized equipment of limited availability; (g) the presence of endangered species; (h) financing delays of less than six months; and (i) supply shortages.

- Cost overruns

Notice

2013-60

- Issued September 20, 2013
- January 1, 2016 safe harbor for continuous efforts and program of continuous construction
- Master contract can be replaced by project contract for five percent safe harbor
- Successor in interest rule

2014-46

- Issued October 8, 2014
- Clarification of physical work
- Clarification of transfers
- Three percent safe harbor

Notice

2015-25

- Issued March 11, 2015
- Extended begun construction dates in prior guidance
- Extended deemed continuous safe harbor for all projects through 2016, regardless of whether construction started in 2014 or prior

2016-31

- Issued May 5, 2016
- Extended and modified deemed continuous safe harbor
- Prohibition against combining methods (PWSN vs. 5%) in alternating calendar years
- Additional examples of on-site physical work of a significant nature (hydro, biomass, geothermal)
- Additional examples of excusable disruptions
- Timing of single project determination
- Disaggregation rule
- Application of Five Percent Safe Harbor to retrofitted facilities (repowering)

Notice 2017-04

2017-04

- Issued January 2017
 - Provides added certainty to taxpayers planning to grandfather or “re-start” construction in 2016 on projects that may have started in earlier years in order to qualify for a 100-percent value PTC or ITC in lieu of PTC
- Addresses three tax technical issues that emerged after the IRS issued Notice 2016-31
 - Retroactivity
 - Alternating Methods
 - Repowering

Physical Work

Notice 2013-29

2013-29

- Issued April 15, 2013
- “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.”
- The IRS then provided illustrative examples of both on-site and off-site work:

For example, in the case of a facility for the production of electricity from a wind turbine, on-site physical work of a significant nature begins with the beginning of the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation. **If the facility’s wind turbines and tower units are to be assembled on-site from components manufactured off-site by a person other than the taxpayer and delivered to the site, physical work of a significant nature begins when the manufacture of the components begins at the off-site location, but only if (i) the manufacturer’s work is done pursuant to a binding written contract (as described in section 4.03(1)) and (ii) these components are not held in the manufacturer’s inventory (as described in section 4.02(2)). If a manufacturer produces components for multiple facilities, a reasonable method must be used to associate individual components with particular facilities** (emphasis added).

Notice 2013-29

On-site Physical Work

- “On-site physical work of a significant nature begins [at a wind farm] with the beginning of the excavation for the foundation, the setting of anchor bolts into the ground, **or** the pouring of the concrete pads for the foundation”.
- In another example of on-site physical work, the IRS concluded that work on “roads primarily for access to the site, or roads used primarily for employee or visitor vehicles” does not qualify. Physical work of a significant nature does include, however, starting construction on roads that are “integral to the facility,” for example, “roads for equipment to operate and maintain” the facility and “roads that are used for moving materials to be processed.” Physical work of a significant nature does not include “preliminary activities, even if the cost of those preliminary activities is properly included in the depreciable basis of the facility.”
- Guidance does not provide any threshold amount of on-site physical work.

Off-site Physical Work

- “To satisfy the physical work test, the work performed must be on tangible personal property or other tangible property that is integral to the power generating activity of the facility. Work performed on transmission equipment or buildings typically does not count. **Exceptions include physical work on a custom-designed transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission,** or a building that is essentially an item of equipment or is so closely related to the use of the generation property it houses that it is reasonable to expect that the building would be replaced at the same time as the property
- **“Physical work on a custom-designed transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission is physical work of a significant nature with respect to the facility** because power conditioning equipment is an integral part of the activity performed by the facility.”

Notice 2013-29

Off-site Physical Work

Inventory Rule

- Components manufactured off-site cannot come from the manufacturer's inventory and cannot be equipment that the manufacturer normally holds in its inventory. The work performed can be done by the taxpayer or by a contractor for use in the taxpayer's trade or business (or for the taxpayer's production of income).

Binding Written Contract Rule

- Any work performed by a contractor is taken into account for this purpose only if it was done under a binding written contract with the taxpayer and the contract was in place before the work began. A contract is binding only if it is enforceable under state law against the taxpayer or a predecessor and does not limit damages to a specified amount. A contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount.

Notice 2013-29

Continuous Program of Construction

- “A continuous program of construction involves continuing physical work of a significant nature”
- Excusable disruptions
 - (a) severe weather conditions; (b) natural disasters; (c) licensing and permitting delays; (d) delays at the written request of a state or federal agency regarding matters of safety, security, or similar concerns; (e) labor stoppages; (f) inability to obtain specialized equipment of limited availability; (g) the presence of endangered species; (h) financing delays of less than six months; and (i) supply shortages.

Notice 2014-46

- Issued October 8, 2014
- IRS specifically clarified the physical work test in Notice 2014-46
- Emphasized that “[t]his test focuses on the nature of the work performed, not the amount or cost,” by providing a non-exclusive list of activities that will satisfy the physical work test.
 - One of those activities specifically enumerated is “physical work on a custom-designed step-up transformer.” Other activities enumerated include “beginning of the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation” and “[r]oads that are integral to the facility”
 - IRS concluded that “***[b]eginning work on any one of the activities described above will constitute physical work of a significant nature.***”
 - “Assuming the work performed is of a **significant nature, there is no fixed minimum amount of work or monetary or percentage threshold required** to satisfy the Physical Work Test.”
- Clarified an example from Notice 2013-29, in which site excavation and concrete pouring occurs at 10 of 50 turbine sites: [the example was] “not intended to indicate that there is a 20% threshold or minimum amount of work required to satisfy the Physical Work Test.”

Notice 2014-46

IRS based clarification of the physical work test on prior begun construction standards:

- Bonus depreciation, tax exempt bond financing, and old investment credit transition rules provided in rulings and legislative history
 - “In addition, **work of a significant nature on a major component must begin. However, starting work on a major component does not mean that a significant amount of work must be completed on the major component for commencement to start**”.
 - “The construction of a machine or equipment is to be considered as begun when work of a significant nature has begun with respect to the machinery or equipment. **Thus, if the foundation or installation is significant and this has begun, the construction of the machine or equipment will be considered to have begun. If manufacturing on important parts of the machine has begun, construction will be considered as commenced. Similarly, if assembly of parts (other than from inventory) has begun, this too will indicate the beginning of construction of the machine or equipment. However, construction on a machine or equipment will not be considered as begun if work has begun only on minor parts or components of the machine or equipment**”.

Notice 2016-31

-
- Issued May 5, 2016
 - Discusses the physical work test:
 - **“As provided in section 3 of Notice 2014-46, this test focuses on the nature of the work performed, not the amount or the cost. Assuming the work performed is of a significant nature, there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the Physical Work Test.”**
 - Provides additional examples of on-site physical work “intended to illustrate physical work of a significant nature for different types of renewable energy facilities and is non-exclusive.”

Continuity Safe Harbor

Continuity Safe Harbor update

Notice 2016-31 (released 5/5/16; re-released 5/18/16)

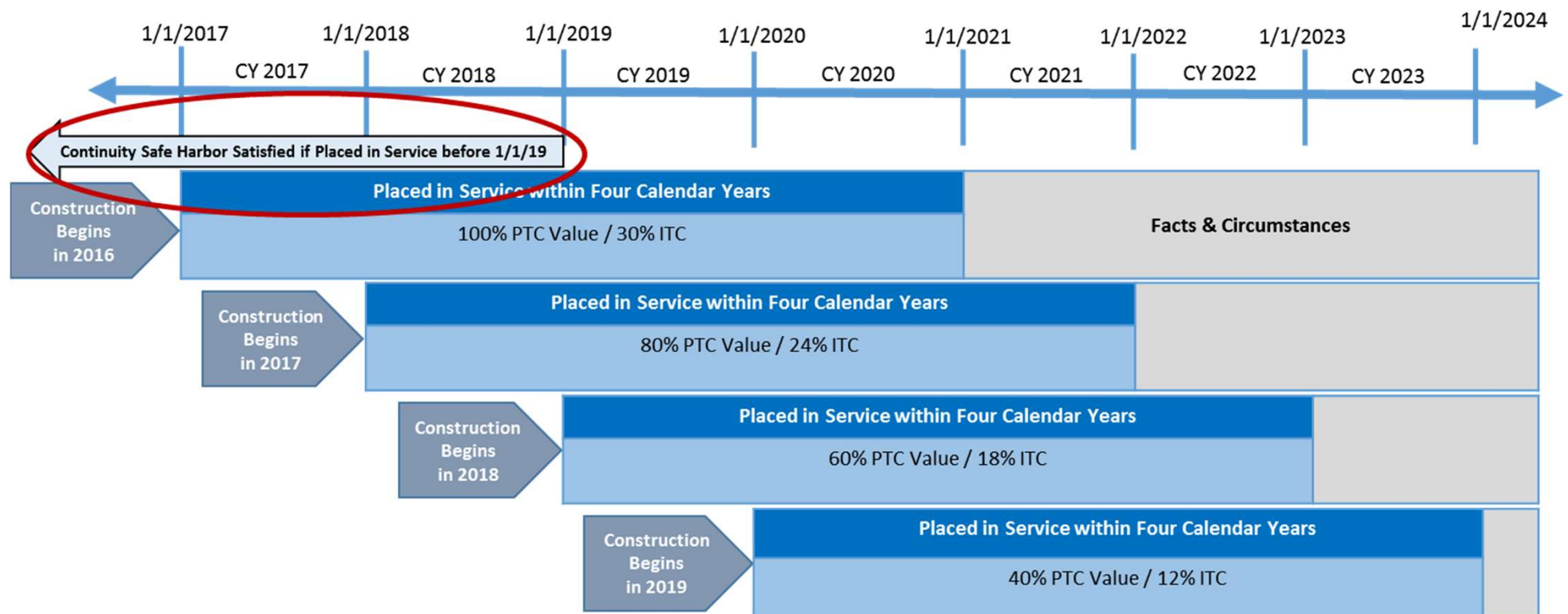
- Impacts PTC and ITC in lieu of PTC (wind, biomass, hydro, geothermal, waste-to-energy)
- Extension and modification of Continuity Safe Harbor
 - Must be placed in service by the later of four years after calendar year during which BOC occurs or December 31, 2018
 - Prohibition against combining method (PWSN vs. 5%) in alternating calendar years
- Additional examples of excusable disruptions
- Timing of single project determination
- Disaggregation rule

Notice 2017-04

- Provides added certainty to taxpayers planning to grandfather or “re-start” construction in 2016 on projects that may have started in earlier years in order to qualify for a 100-percent value PTC or ITC in lieu of PTC
- Retroactivity
- Alternating Methods

Continuity Safe Harbor

Begun construction guidance after Notice 2016-31 with retroactive “fix”



Transfers

After construction begins

- Relocations
 - “A taxpayer also may begin construction of a facility in 2013 with the intent to develop the facility at a certain site, but thereafter transfer equipment and other components of the facility to a different site, complete its development, and place it in service. The work performed or amount paid or incurred prior to January 1, 2014, by such a taxpayer may be taken into account for purposes of determining whether the facility satisfies the Physical Work Test or the Safe Harbor.”
- Transfers of Equipment and Acquisitions of Projects
 - The transfer of a facility between taxpayers was expressly contemplated and permitted in Notice 2013-60
 - The IRS provided that a taxpayer may claim the PTC or ITC in lieu of PTC for a qualified facility that satisfies the Physical Work Test or 5% Safe Harbor, “even if the taxpayer did not own the facility at the time construction began.”
 - Notice 2014-46 further clarified the ability of taxpayers to transfer facilities (both partially and fully constructed) amongst related or unrelated entities. The IRS generally allowed for the transfer between related taxpayers of any equipment or facility on which construction began without that facility “losing its qualification under the Physical Work Test or the [5%] Safe Harbor.”
 - However, a taxpayer may not transfer solely tangible personal property to an unrelated party.
 - Joint ventures and disguised sale rules
 - Bundling tangibles and intangibles / timing

Transfers example

Scenario: Taxpayer A purchased 100% PTC-value wind turbine components for Project 1 in 2016. Project 1 does not have any associated intangibles that can be transferred.

- Taxpayer B (an unrelated company) is developing a different wind project, Project 2, that only has land, permits and other intangibles like a PPA. Taxpayer B wants to partner with Taxpayer A and use Taxpayer A's wind turbine components to qualify Project 2 for 100% value PTCs.
- In May of 2018, Taxpayer A and Taxpayer B form a Partnership, with Taxpayer A contributing wind turbines worth \$25 and Taxpayer B contributing the project development rights worth \$75. All dealings between Taxpayer A and Taxpayer B are at arm's length, with no out-of-market guarantees, indemnities, puts or calls, so that both partners undertake the risk involved with financing and constructing Project 2.
- The Partnership finances, obtains the remainder of the equipment, and constructs Project 2 throughout 2019 into 2020.
- In July of 2020, Taxpayer B purchases Taxpayer A's partnership interests and Taxpayer A is no longer a partner in the Partnership.
- In September of 2020, Taxpayer B places Project 2 into service.

Variation 1: In February of 2019, Taxpayer B contributes more cash and equipment into the Partnership worth \$100 resulting in Taxpayer A's partnership's interest being reduced to 12.5%. Taxpayer A does not withdraw any cash from the Partnership.

Variation 2: In May of 2019, Taxpayer B purchases Taxpayer A's partnership interests so Taxpayer A is no longer a partner in the Partnership.

Begun construction considerations for offshore wind

PTC and ITC in lieu of PTC Considerations for offshore wind

- Timing Considerations / Longer Construction Schedule
 - 60% PTC/ITC in lieu of PTC with continuous construction/efforts by facts and circumstances vs. 40% PTC/ITC in lieu of PTC with Continuity Safe Harbor
 - Continuous Efforts generally preferable to Continuous Construction
 - Physical Work may be preferable to 5% Safe Harbor at times
 - Much less capital intensive
 - Filling the 5% bucket - cables, leases?, indirect costs, changing technology

PTC and ITC in lieu of PTC Considerations for offshore wind

- Physical work on shared components
- Binding contracts and material modifications
- Work performed by subcontractors
- 5% Safe Harbor Look-through Rule
 - Cost incurred under IRC section 461
 - Percentage of completion method (“PCM”) for long-term manufacturing contracts
 - Costs are considered incurred at the earlier of payment (assuming such payment is due under the terms of a contract), or when tax ownership of the property is transferred.
 - PCM + 3.5 month rule

PTC and ITC in lieu of PTC Considerations for offshore wind

- Excusable disruptions foreseeability
- Multiple tax-equity investors
- Recapture if claiming the ITC
- Use within the United States / tax-exempt use
- Base erosion anti-abuse tax
 - ITC vs. PTC

Begun construction for repowering

Repowering wind projects

Repowering a wind project re-starts the 10-year PTC period

- Opportunity to replace components of wind turbines (e.g., nacelle, blades, hubs) with new technology
- If the cost of the new property is 80% or more of the total cost of the new property plus fair market value of the used facility, then the facility is considered placed in service anew restarting the 10-year PTC period
- Potential Issues:
 - How to value the new and used property (e.g., cost, income approach)
 - Tax Equity Comfort?
 - Government not planning to issue PLRs or provide further guidance

Beginning construction on a repower

- 5% Safe Harbor vs. Physical Work Test
- Single project election vs. each facility
- Total cost of the facility

ITC Begun Construction Rules

Notice 2018-59

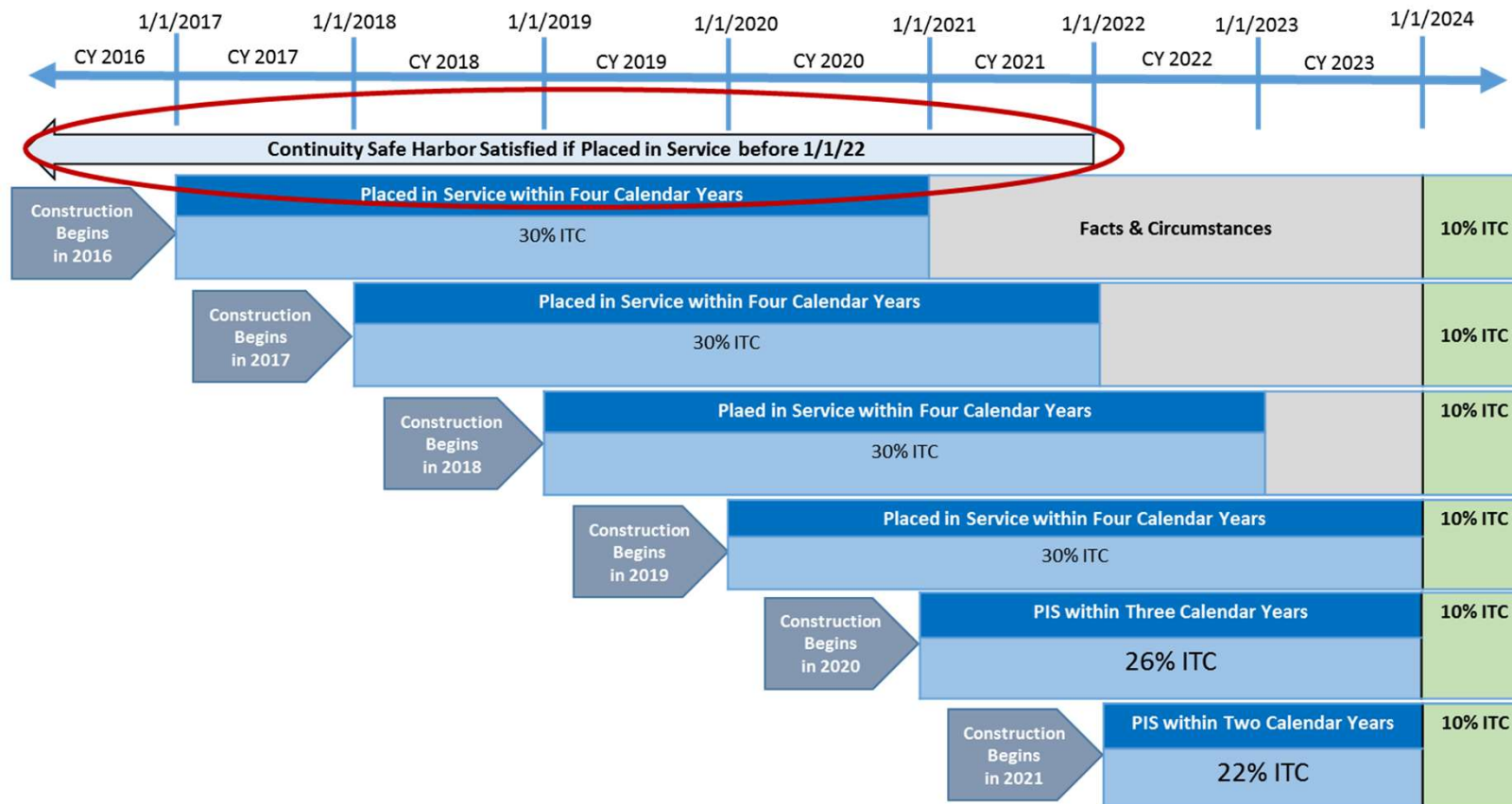
Begun construction guidance for ITC

SEIA Recommendations for solar begun construction guidance

- Provide a technology-neutral Continuity Safe Harbor that aligns with the statutory placed-in-service deadline
- Confirm eligibility of property integral to the qualifying activity and provide examples
- Clarify the relevant unit of property and adopt a single project election for units of solar energy property under the ITC
- Clarify application of inventory rule
- Provide specific examples of physical work of a significant nature on solar energy property
- Adopt Five Percent Safe Harbor and incorporate a scale-back provision in recognition of cost over-runs that commonly occur in the project development process
- Clarify requirements to preserve ITC eligibility when a project or solar energy property is transferred
- Provide excusable disruptions specific to solar project development

Begun construction for solar ITC

SEIA's requested Continuity Safe Harbor



Notice 2018-59

Purpose & Background

- Guidance for determining the beginning of construction on various types of energy property (solar, CHP, fuel cells, microturbines, geothermal) that is eligible for the § 48 ITC
- **Prong 1**: To qualify for ITC, taxpayers must satisfy either the Physical Work Test or the 5% Safe Harbor
- **Prong 2**: Once construction begins, taxpayers must satisfy the Continuity Requirement
- Response to industry questions and concerns



Notice 2018-59

Physical Work Test

- Construction of energy property begins when physical work of a significant nature begins
 - Physical work of a significant nature
 - On-site and off-site physical work
- Does not include preliminary activities
- Does not include work to produce components of energy property existing or normally held in inventory

Notice 2018-59

Five Percent Safe Harbor

- Construction of energy property will be considered as having begun if a taxpayer pays or incurs 5% or more of the total cost of the energy property
 - Single project
 - Single energy property
 - Total cost of energy property
 - Cost overruns

Notice 2018-59

Continuity Requirement

- After satisfying the Physical Work Test or the 5% Safe Harbor, a taxpayer must meet the Continuous Construction Test or Continuous Efforts Test
 - Continuous Construction Test
 - Maintain a continuous program of construction
 - Continuous Efforts Test
 - Maintain continuous efforts to advance towards completion
- Continuity Safe Harbor
- Excusable Disruptions

Notice 2018-59

Transfers of Energy Property, Components, and Equipment

- Fully and partially developed energy properties can be transferred without losing their qualifications for ITC
 - Transfer energy property from one taxpayer to another
 - Transfer components of property from one location to another
 - Transfers of equipment between unrelated parties will not be considered for the Physical Work Test or the 5% Safe Harbor

Notice 2018-59

Other Applicable Rules

- Property integral to energy property
- Multiple energy properties and disaggregation
- Construction by contract
- Look-through rule
- Retrofitted energy property 80/20 Rule
- Combination of methods
 - Construction will be deemed to have begun on the date the taxpayer first satisfies either the Physical Work Test or the 5% Safe Harbor

Notice 2018-59

Overall Observations

- Notice applies industry-favorable rules similar to those for PTC
- Generous 4-year Continuity Safe Harbor
- Changes made to initially released versions
- Differences between ITC and PTC guidance
- Changes
 - Physical Work on transformers that step up to 69kV or greater
 - Unit of energy property vs. qualified facility
 - Property up to and including the inverter
 - Alternating Methods
 - Excusable disruptions do not toll the Continuity Safe Harbor period
 - 3% Safe Harbor removed

Notice 2018-59

Overall Observations

- Differences between ITC and PTC guidance
- Missed opportunities
 - Storage eligibility as integral part
 - Inventory – language is overly broad
 - Transfers – what intangibles are required
- Strategy planning
- IRS will not issue PLRs or determination letters

Tax controversy trends

Tax controversy trends - Background

- Section 1603 Grant Controversy
 - Many taxpayers were challenged on Section 1603 grant requests
 - Issues raised by Treasury
 - Valuation
 - Purchase price allocations
 - Eligible basis
 - Development fees
 - Affiliated party transactions
 - Projects awarded grants on a “cost-plus” basis
 - Treasury white paper “Evaluating Cost Basis for Photovoltaic Properties”
 - “While appropriate markups are case-specific and can depend on the ultimate transaction price, the 1603 review team has found that appropriate markups typically fall in the range of 10 to 20 percent.”

Tax controversy trends – IRS audit activity

- IRS Audits / Tax Controversy
 - Starting to see more audit activity, particularly solar ITC
 - Issues raised by IRS
 - Reconciling 1603 grant award “haircuts” with the ITC claimed on substantially similar installations
 - Understanding tax equity structures
 - Valuation
 - Purchase price allocations
 - Eligible basis
 - Development fees
 - Affiliated party transactions
 - Long process / multiple IDRs
 - Unlike 1603 grant program hazards of litigation must be taken into account by IRS (at least at the Appeals level)

Typical tax indemnities provided by sponsor

- Tax Structure Risk – NO
- Begun Construction Risk – NO
- ITC Basis Risk - YES
 - Fair Market Value
 - Development fee
 - Affiliated party transactions
 - Eligible basis
- ITC Recapture Risk – YES, but only to the extent attributable to actions undertaken by the Sponsor

Alta Wind and other 1603 Grant Litigation

Alta Wind

- Background
 - Congress passed the American Recovery and Reinvestment Act in the wake of the 2008 financial crisis to stimulate the U.S. economy.
 - Section 1603 created a system in which certain renewable energy facility owners became entitled to cash grants in lieu of tax credits (“Section 1603 Grants”).
 - Owners of “specified energy property” became entitled to grants equal to 30% of “the basis of such property” in lieu of claiming ITC or PTC.
 - The Alta Wind Energy Center contains six wind power facilities at issue in which the plaintiffs alleged that the government underpaid the plaintiffs by more than \$206 million related to the Section 1603 Grant.

Alta Wind

- Claims Court Case – *Alta Wind I Owner Lessor C v. United States*, 128 Fed. Cl. 702 (2016)
 - Plaintiffs argued that “basis” meant the purchase price of their wind power facilities less small allocations for ineligible property, such as, land and energy transmission lines.
 - Government argued that basis should be calculated from the value of each wind farm’s grant-eligible constituent parts and their respective development and construction costs. The government also argued the purchases were subject to IRC § 1060, which provides that a residual method of tax accounting requires a substantial portion of the wind farms’ purchase prices to be allocated as intangibles, for instance, goodwill and going concern value.
 - The government’s expert witness was excluded from providing testimony and a report on the value of the eligible property at the time of the Alta Wind transactions for purposes of determining the plaintiff’s basis in eligible property.
 - Claims Court held in favor of the plaintiffs by determining the basis in wind farm facilities must be calculated according to the facilities’ purchase price less reasonable allocations for land and other grant-ineligible property. The Claims Court also held that there were no peculiar circumstances inflating the purchase price, as the government contended.

Alta Wind

- Federal Circuit Case – *Alta Wind I Owner Lessor C v. United States*, No. 17-1410 (Fed. Cir. 2018)
 - On appeal from the government, the Federal Circuit was tasked with determining how to calculate the plaintiff's basis in eligible property for purposes of the Section 1603 Grants and whether the lower court erred by excluding the expert witness's testimony.
 - Both parties agreed that the portion of the purchase prices attributable to grant-ineligible property (e.g., real estate, transmission equipment, and buildings) must be excluded from eligible basis. The differences between the parties' positions were related to the allocation of the remainder of the purchase prices.
 - Plaintiffs argued that the remainder of the basis could be allocated to grant-eligible tangible personal property with none allocated to intangibles.
 - The government argued that the transaction included intangibles (e.g., goodwill and going concern value), and the remaining purchase price therefore must be allocated between grant-eligible tangible personal property and grant-ineligible intangibles using the residual method required by IRC § 1060.

Alta Wind

- Federal Circuit Case (cont.)
 - The Federal Circuit ruled that acquisition of six completed windfarms constituted “applicable asset acquisitions” to which the residual allocation method of § 1060 applies, notwithstanding that none of the windfarms had been placed in service for tax purposes prior to the sale transaction.
 - The Federal Circuit held the lower court erred in refusing to utilize the residual method of § 1060 and in not affording the government an opportunity to present an expert witness to testify to the appropriate basis calculation. The Claims Court decision was vacated and remanded, with specific instructions to reassign the case to a different Claims Court Judge.
 - In applying the residual allocation method, the Federal Circuit directs the Claims Court, upon remand, to distinguish between “turn-key value” and “goodwill and other intangibles.” According to the Federal Circuit, tax basis in turn-key value falls within Class V of the § 1060 waterfall whereas goodwill and other intangibles falls within Class VI and VII.
 - Turn-key value would be eligible for the Section 1603 Grant, while goodwill and other intangibles would not constitute eligible basis for the Section 1603 Grant.

Alta Wind

- Federal Circuit Case (cont.)
 - The Federal Circuit held that, “A group of assets constitutes a trade or business if the “character” of the group of assets transferred “is such that goodwill or going concern value could under any circumstances attach.” Treas. Reg. § 1.1060-1(b)(2)(i)(B). There is no need to show that a transaction had actual, accrued goodwill or going concern value at the time of the transaction.”
 - Federal Circuit explained, “The regulations define “goodwill” as “the value of a trade or business attributable to the expectancy of continued customer patronage” and define “going concern value” as “the additional value that attaches to property because of its existence as an integral part of an ongoing business activity.” Id. § 1.1060-1(b)(2)(ii).”
 - “[T]he purchase prices for the Alta facilities were negotiated based on anticipated cash flows that would occur once the facilities became operational. Those cash flows depended on—and were valued with reference to—intangible assets such as PPAs. In short, when plaintiffs purchased the windfarms, they were purchasing the expectation of future cash flows based on an established customer relationship.”
 - “Finally, the regulations themselves make clear that a business that is not yet operational in the sense that it is not yet serving customers and generating revenue can have goodwill.”

Alta Wind

- Key Takeaways
 - The Federal Circuit holding vacates a decision that was taxpayer-favorable and supported increased ITCs and accelerated depreciation for solar, wind, and other renewable energy ITC property.
 - The holding provides that allocations of tax basis to ITC-qualifying property are required both:
 - Prior to an ITC-eligible project's placed-in-service date; and
 - After a project has already been placed in service, such as in subsequent sales of energy property or sales of equity interests in energy property (e.g., with respect to the allocation of IRC § 743 adjustments to partnership property).
 - The holding implies that a PPA and an Interconnection Agreement are each an "other intangible" that may be determined to be Class VI property to which separate value attaches, resulting in ineligible basis.
 - Such a holding for Section 1603 Grant purposes would have implications for ITC and accelerated depreciation purposes.

Other 1603 Grant Cases

- Ampersand Chowchilla Biomass LLC et al. v. United States; No. 1:14-cv-00841: 1603 grant decision re: biomass facilities
- California Ridge Wind Energy LLC v. United States; No. 14-250: 1603 grant decision re: wind facilities
- Bishop Hill Energy LLC et al. v. United States; No. 14-251: 1603 grant decision re: wind facilities
- Westrock Virginia Corp. v. United States; No. 1:15-cv-00355: 1603 grant decision re: biomass facility
- McCoy Solar LLC v. United States; No. 1:18-cv-00149: 1603 grant complaint re: solar property
- Silver State LLC v. United States; No. 1:18-cv-00266: 1603 grant complaint re: solar property
- Desert Sunlight 250 LLC v. Lew; No. 15-cv-01051: 1603 grant complaint re: solar property



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