

# Client Alert

December 2016

## **IRS Issues Updated Guidance on Beginning of Construction Requirements Under Sections 45 and 48 of the Internal Revenue Code**

The Internal Revenue Service has issued updated guidance on the “beginning of construction” requirement under Sections 45 and 48 of the Internal Revenue Code. On December 15, 2016, the Internal Revenue Service released Notice 2017-04, 2017-[ ] I.R.B. [ ] (“Notice 2017-04” or “the Notice”), which provides updated guidance on the beginning of construction requirement. The Notice extends and modifies the guidance previously provided in Notice 2013-29, 2013-1 C.B. 1085, Notice 2013-60, 2013-2 C.B. 431, Notice 2014-46, 2014-36 I.R.B. 520, Notice 2015-25, 2015-13 I.R.B. 814, and Notice 2016-31, 2016-23 I.R.B. 1022 (collectively, the “Prior IRS Notices”). Notice 2017-04 extends, modifies, and clarifies Notice 2016-31 with respect to the “Continuity Safe Harbor” and clarifies the application of the 5 percent safe harbor to retrofitted (or repowered) facilities. The Notice provides that the prior guidance continues to apply except as specifically changed.

The guidance in Notice 2017-04 is relevant for facilities claiming the production tax credit under Section 45, including wind facilities. Notice 2017-04 does not provide guidance for the ITC for solar energy facilities, but it confirms that such guidance is forthcoming.

### **Modifications and Additional Guidance on the Continuity Safe Harbor**

The Prior IRS Notices provide that once construction has begun under either the physical work test or the 5 percent safe harbor, that there must be continuous construction or continuous efforts (collectively, the “continuity requirement”). Notice 2016-31 discontinued the practice of fixing specified dates by which a facility must be placed in service to satisfy the continuity requirement and instead provides that a facility must be placed in service by the later of (1) a calendar year that is no more than four calendar years from the calendar year in which the facility began construction (the “four-year lookback”), and (2) December 31, 2016 (the “Continuity Safe Harbor”). Notice 2016-31 provides an example, stating that a facility on which construction begins on January 15, 2016, will be deemed to satisfy the Continuity Safe Harbor if that facility is placed in service by December 31, 2020.

Notice 2017-04 extends the December 31, 2016 deadline to December 31, 2018. This means that any facility that is placed in service by December 31, 2018 will satisfy the Continuity Safe Harbor and thus, be deemed to satisfy the continuity requirement. Notice 2017-04 confirms the example in Notice 2016-31 and provides a new example: if construction begins on a facility on January 15, 2013, and the facility is placed in service by December 31, 2018, the facility will be considered to satisfy the Continuity Safe Harbor. Any facility placed in service after December 31, 2018 will be required to apply the four-year lookback.

Notice 2016-31 imposes a rule that a taxpayer may not delay the begun construction date of a facility for purposes of the Continuity Safe Harbor by relying upon the Physical Work Test and the 5 percent safe harbor in alternating calendar years. The Notice states, for example, that if a taxpayer performs physical work in 2015 and then incurs 5 percent or more of the total cost of the facility in 2016, the Continuity Safe Harbor will be applied beginning in 2015, not 2016. In other words, you must determine application of the Continuity Safe Harbor based on the first year in which construction began. You cannot move that date

forward by doing additional work or incurring additional costs in a subsequent year. Notice 2017-04 clarifies that the prohibition on alternating methods only applies to facilities for which construction commenced after June 6, 2016. This suggests that any facilities that commenced construction prior to June 6, 2016 may use the last year in which one of the two methods was satisfied as the start date for the four-year lookback.

### **Application of the 5 Percent Safe Harbor to Repowered Facilities**

As stated in the Prior IRS Notices, a facility may qualify as originally placed in service, despite containing used property if such used property comprises no more than 20 percent of the total value of the facility. This rule is generally referred to as the 80/20 rule. The 80/20 rule applies separately to each facility, i.e., each separate wind turbine. Notice 2017-04 confirms that, in circumstances where new property is used to retrofit or repower an existing facility, only costs relating to the new construction should be taken into account for purposes of satisfying the 5 percent safe harbor. The costs incurred for the new work are then compared to the total costs for all of the new work to determine whether the 5 percent safe harbor is satisfied. No part of the value of the old property is taken into account in applying the 5 percent safe harbor test. Notice 2017-04 clarifies that for purposes of the 80/20 rule, the cost of new property includes all costs properly included in the depreciable basis of the new property.

The new guidance provides needed comfort and clarity in evaluating which projects will satisfy the beginning of construction requirement.

Click the following link for a copy of [Notice 2017-04](#). If you have any questions regarding the Notice, please contact us.

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