



Treasury gives favorable response to senators' request for "begun construction" extension

By Shariff Barakat and Forrest David Milder

Summary

On April 23, 2020, in response to COVID-19, a bipartisan group of senators — including Finance Chair Grassley, as well as Wyden, Thune, Cantwell, Murkowski, and Manchin — delivered a letter to Secretary of the Treasury Mnuchin urging Treasury to extend the "continuity safe harbor" for renewables projects that began construction in 2016 or 2017 (click [here](#)). Yesterday (May 7), Treasury wrote back to the senators indicating that Treasury "plans to modify the relevant rules in the near future" (click [here](#)).

This is a very promising development for renewable energy projects, particularly utility-scale wind power projects, that were qualified for higher levels of PTCs and ITCs based on actions taken in 2016 and 2017. Projects that were qualified based on activity in 2016 are currently required to be operational by the end of 2020 in order to have a high degree of certainty about the level of tax credits that such projects are entitled to. As a result of supply-chain disruptions and government-mandated work stoppages, the ability of many of these "2016 projects" to achieve operational status in 2020 is looking grim. For projects that began construction in 2017, the deadline is the end of 2021; while this is less dire, there's still a high level of concern in the industry about whether these "2017 projects" can cross the finish line by the end of 2021.

The response from Treasury is a breath of fresh air for the developers and construction lenders of these projects; any relief provided by Treasury is welcome. Ideally, it will be in the form of a one-year extension of the deadline as requested by the senators.

Background

Renewable energy projects in the United States can be eligible for lucrative production tax credits (PTCs) and investment tax credits (ITCs). While these credits have been available intermittently for many years, the method by which projects qualify for tax credits has changed over time.

Initially, eligibility for the tax credits was based on when a project was placed into service. Due to the nature of power plant development, and because Congress rarely extended the credits for more than one to two years at a time, developers took the timeline risk that a project would be delayed and not operational by the deadline then in effect. In a major win for the renewables industry,

Congress changed the method of qualifying renewable energy projects to take an additional factor into account: When did the project “begin construction”? The idea is to qualify projects based on the tax credits available at the time a developer evidences a commitment to develop a project, rather than solely on when the project becomes operational. The “began construction” test greatly eases the enormous development and construction timeline risk that otherwise applies to tax credits.

In response to this legislative change, Treasury released a series of IRS Notices providing guidance about what it means to have “began construction” on a project. The Notices contain two tests; passing either one establishes that construction has begun. The first is a quantitative spend-based method of demonstrating that construction began as of a certain date, often called the “5% Safe Harbor.” The second is a qualitative facts-and-circumstances method of demonstrating that “physical work of a significant nature” began as of a certain date.

While some of the details have moved a bit over time, the IRS has always included an additional “continuity requirement” that applies to both tests. It requires developers to make “continuous efforts” to advance toward completion of the project in the quantitative method and to maintain a “continuous program of construction” in the qualitative method, along with an objective safe harbor to satisfy the continuity requirement. Under this safe harbor, the continuity requirement will be deemed to be satisfied if a project is placed into service by the end of the year that includes the fourth anniversary of when construction began on the project.

It should be noted that failing to satisfy the safe harbor for the continuity requirement does not disqualify a project per se. Instead, the developer is forced to demonstrate that the continuity requirement is nevertheless satisfied by the history of the developer’s actions with respect to the project. While the IRS Notices have described impediments that can extend the continuity requirement, these can be subjective and do not necessarily provide confidence for investors. For example, worldwide pandemic is not one of the listed exceptions. As a result, under current law, most tax-equity commitments for wind projects that began construction in 2016 or 2017 are contingent on the project being placed in service by the end of 2020 or 2021, respectively.

With the current four-year safe harbor for 2016 projects expiring at the end of 2020, this year was expected to be a big year for wind. Developers took steps to demonstrate that gigawatts of projects “began construction” in 2016 and 2017. Now, to have certainty that the IRS continuity requirement will be satisfied for those projects, the projects have to be placed in service by the end of 2020 or 2021, respectively. Of course, with the disruptions from COVID-19, there is concern that many of these projects will not be placed into service in time. Many developers and tax-equity investors banked on their conviction that a project would be placed in service by the relevant deadline and many do not have a backup plan to show subjective compliance with the continuity requirement. Thus, a failure to extend the four-year safe harbor window for the continuity requirement could cause devastating losses throughout the renewables industry, reaching into the billions of dollars. The timing of COVID-19 couldn’t have been worse, since many of these projects began to undertake heavy construction spending at the end of 2019 and beginning of 2020 in anticipation of finishing in the second half of 2020. An extension of the four-year window for the continuity safe harbor will save the industry from billions of dollars in losses and preserve thousands of jobs.

Of course, it should be noted that Treasury’s letter to the senators is notably brief and lacking in details. As a result, we are still left waiting for actual detail about what the new rules will look like.

Nixon Peabody will be closely monitoring these developments in Congress and Treasury related to the begun construction guidance and will provide further updates. We expect developers will be reevaluating current strategies that may have been embarked upon to mitigate timeline risk and that financiers will be closely scrutinizing the steps taken by developers to ensure compliance with current and imminent IRS guidance. Please reach out to a member of Nixon Peabody’s renewables

team if you need assistance with navigating tax credit qualification for renewables, including these latest developments on the begun construction safe harbors.

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