

Alert | Tax/Energy & Natural Resources

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Tax Credits for Wind and Solar Facilities Under the Republican Tax Plan

On Thursday, Nov. 2, 2017, the House Republicans unveiled their long-awaited tax plan, which was introduced as a Bill (H.R. 1) entitled the “**Tax Cuts and Jobs Act**” (the “Act”). While the Act has yet to be passed by the House, and it is likely to change in the legislative process, it contains proposals affecting the solar and wind industries which deserve to be carefully monitored. In addition to lowering income tax rates, which would, in general, make the tax benefits from investments in solar and wind facilities less valuable, as discussed in detail below, the Act would also make changes to the primary tax incentives relative to solar and wind facilities; namely, the investment tax credit and the production tax credit. While these changes may present planning opportunities, they also create issues and uncertainties, which hopefully will be clarified as the legislation progresses.

Solar Facilities

Under the current law, a solar electric generating facility the construction of which is commenced prior to 2020 will generally qualify for an investment tax credit (“ITC”) in the year the facility is placed in service in an amount equal to 30 percent of the tax basis of the facility. If construction of the facility commences in 2020 or 2021, the rate of ITC is reduced to 26 percent and 22 percent, respectively. For a facility the construction of which commences after 2021, the rate of ITC is reduced to 10 percent.

The Act leaves the ITC regime discussed above largely unchanged; however, it eliminates the 10 percent ITC for solar facilities the construction of which commences after 2027. The Act also extends the availability of tax credits for fiber-optic solar equipment, qualified fuel cells, qualified small wind energy property, qualified microturbine property, combined heat and power systems, thermal energy property and residential energy efficient property. A discussion of these tax credits is beyond the scope of this Alert.

The Act would impose a “continuous construction” test for purposes of determining the year in which construction of a solar facility has commenced. New Code Section 48(c)(5) would provide that:

The construction of any facility, modification, improvement, addition, or other property shall not be treated as beginning before any date unless there is a continuous program of construction which begins before such date and ends on the date that such property is placed in service.

New Section 48(c)(5) appears to be retroactive in effect, since it applies “to taxable years beginning before, on, or after the date of the enactment of this Act.”

The continuous construction test has been a part of the ITC landscape since it was announced by the IRS in [Notice 2013-29](#). It is part of a two-part test for determining the year in which construction of an ITC qualifying facility has commenced (the “Physical Work Test”). The Physical Work Test is subjective in nature, and turns on whether physical work of a significant nature has begun on a facility in the year in question. The continuous construction test represents the second part of the Physical Work Test. Under this part of the test, the taxpayer must demonstrate that it has maintained a continuous program of construction from the time that physical work began on the facility until the time that the facility is placed in service. A continuous program of construction requires “continuing physical work of a significant nature.” (Emphasis added).

As an alternative to the Physical Work Test, IRS Notice 2013-29 also offers a more objective “safe harbor” test, which simply requires the taxpayer to pay or incur five percent or more of the total cost of the facility in the year in question (the “Five Percent Safe Harbor”). Similar to the Physical Work Test, the Five Percent Safe Harbor has a second part, which focuses on the taxpayer’s subsequent conduct. In order to satisfy this second part of the Five Percent Safe Harbor, the taxpayer must show that it has made “continuous efforts” to advance the completion of the facility. Unlike the continuous construction test, the continuous efforts test does not require that physical work on the facility be ongoing. Instead, the continuous efforts test may be satisfied by simply paying or incurring additional amounts with respect to the facility, or obtaining permits for the facility.

The continuous construction test and the continuous efforts test have been largely blurred and made less relevant by subsequent notices issued by the IRS. These notices establish a safe harbor under which both the continuous construction test and the continuous efforts test will be deemed satisfied if the facility in question is placed in service within four years of the year in which construction of the facility began (the “Continuity Safe Harbor”). See, [IRS Notice 2016-31](#) and [IRS Notice 2017-4](#).

It is unclear what the drafters of the Act intended by retroactively imposing the continuous construction test to determine the year in which construction of a solar facility has commenced. Was the intent to retroactively repeal the continuous efforts test and/or the Continuity Safe Harbor? If so, does this mean that the IRS may now on audit challenge the ITCs taken by a taxpayer who has relied on the Five Percent Safe Harbor and the continuous efforts test, or the Continuity Safe Harbor, if the taxpayer did not also maintain a program of continuous physical work on the facility? Perhaps there will be further guidance on these points in Committee Reports if and when the Act is passed in final form.

Wind Facilities

Under the current law, a wind facility is entitled to a production tax credit (“PTC”) for each kilowatt hour generated by the facility in the amount of 1.5¢ per kilowatt hour, prior to adjustment for inflation. By statute, the amount of the PTC is required to be adjusted for inflation, and the PTC for a wind facility is currently 2.3¢ per kilowatt hour. A wind facility is eligible for PTCs during the ten-year period following the date on which the facility is placed in service. The PTC is being phased out for wind facilities the construction of which commences after 2016. The PTC for a wind facility the construction of which commences in 2017, 2018, or 2019 is reduced by 20 percent, 40 percent, and 60 percent, respectively. No PTC is available for a wind facility the construction of which commences after 2019. A taxpayer may elect

to claim ITC with respect to a wind facility in lieu of PTCs, but the ITC is similarly phased out for wind facilities the construction of which commences after 2016.

The Act would eliminate the inflationary adjustment to the PTC for wind facilities the construction of which commences after the date of the enactment of the Act. Thus, the PTC for such wind facilities would be 1.5¢ per kilowatt hour (or \$15 per megawatt hour). In addition, as discussed above, the PTC would be further reduced for wind facilities the construction of which commences after 2016. Thus, for wind facilities the construction of which commences after enactment of the Act, the rate of the PTC would be as follows:

<u>Year of Commencement of Construction</u>	<u>PTC</u>
2017	12¢ per kilowatt hour (\$12 per megawatt hour)
2018	9¢ per kilowatt hour (\$9 per megawatt hour)
2019	6¢ per kilowatt hour (\$6 per megawatt hour)

The Act does not reduce the ITC (in lieu of PTC) for wind facilities any further than the currently mandated reductions described above (*i.e.*, 20 percent, 40 percent, and 60 percent for construction commencing in 2017, 2018, or 2019, respectively), since inflation is not taken into account in computing ITCs. Therefore, with respect to any wind facility the construction of which commences after enactment of the Act, it becomes more important than ever to “run the numbers” to see if the ITC would be more advantageous than PTCs (as reduced by the Act).

For purposes of determining the year in which a wind facility commences construction, the Act mandates the same continuous construction test described above with respect to solar facilities. Thus, for purposes of determining the year in which construction of a wind facility commences, the Act raises the same issues and questions discussed above regarding the application of the Five Percent Safe Harbor, the continuous efforts test, and the Continuity Safe Harbor.

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