

IRS Gives Offshore Wind and Federal Land Projects More Time to Qualify for Tax Credits

Notice 2021-05 gives renewable energy developers 10 years to complete projects located offshore or on federal land.

Key Points:

- Developers of offshore and federal land projects now have 10 years to complete their projects after the year in which construction begins to qualify for tax credits under a safe harbor.
- The 10-year safe harbor provides more tax credit certainty to developers of certain long construction cycle projects.
- Developers with projects that had begun construction but were struggling to comply with the IRS's four-year safe harbor are likely to welcome the Notice.

On December 31, 2020, the US Treasury Department and the Internal Revenue Service (IRS) issued Notice 2021-05 (the Notice), which extends an important safe harbor for taxpayers developing renewable energy projects offshore or on federal land. Developers who start construction on offshore projects, including offshore wind projects, or projects located on federal land, now have several additional years to complete these projects after construction has begun. Both the Production Tax Credit (PTC) and Investment Tax Credit (ITC) are subject to reduction if construction of the applicable project has not begun before certain dates, which vary depending on the type of project. Under IRS guidance, a developer can establish the beginning of construction either by incurring 5% of the total eligible costs of the project (the Five Percent Test) prior to the applicable deadline, or by commencing actual physical construction of the project (the Physical Work Test) prior to the applicable deadline.

Once a developer has begun construction, the developer is required to make "continuous efforts" (in the case of projects relying on the Five Percent Test) or maintain a "continuous program of construction" (in the case of projects relying on the Physical Work Test) to complete the project (the Continuity Requirement). Under existing IRS guidance, the Continuity Requirement will generally be deemed satisfied if the project is placed in service within four calendar years after the year during which construction on the project began, or five calendar years if construction began during 2016 or 2017 (the Continuity Safe Harbor). If the Continuity Safe Harbor does not apply, whether or not the developer has maintained a "continuous program of construction" or made "continuous efforts" to complete the project will be determined by the relevant facts and circumstances. This facts and circumstances test has been difficult to apply in practice, and projects that do not qualify for the Continuity Safe Harbor are left with an uncertain path to tax credit qualification.

Extension of the Continuity Requirement for Offshore Projects and Federal Land Projects

The Notice recognizes that projects located offshore or on federal land are subject to significantly greater delays than other projects, and that these delays are outside of the developer's control and can lead to completion times that are twice as long as other projects. The Notice observes that these delays typically include more stringent permitting requirements, lengthier engineering and construction timelines, heightened environmental regulation, and the need to construct new transmission lines. Notwithstanding the Notice's list of typical delays, developers need only to establish that their offshore or federal land project requires the construction of one or more high-voltage transmission lines.

Projects that are located in inland navigable waters or in coastal waters of the United States and require the construction of one or more high-voltage transmission lines to connect to the grid (Offshore Projects) can now qualify for the Continuity Safe Harbor if the project is placed in service by the end of the calendar year that is no more than 10 calendar years after the calendar year during which construction of the project began. Similarly, projects that are located more than 50% on land owned or controlled by the United States (determined by value or area) and that will require the construction of one or more high-voltage transmission lines to connect the project to the grid (Federal Land Projects) can now qualify for the Continuity Safe Harbor if the project is placed in service by the end of the calendar year that is no more than 10 calendar years after the calendar year during which construction of the project began.

The Notice does not change the deadline for solar projects to be completed by the end of 2025 in order to qualify for an ITC greater than 10%. Any change to the solar ITC deadline would have to come from Congress in the form of a change to the Internal Revenue Code.

Key Takeaways

Developers and financing parties have been cautious about investing in projects that could not be completed within the Continuity Safe Harbor and instead had to rely on the facts and circumstances test to satisfy the Continuity Requirement. Although certain types of construction delays, such as those caused by transmission upgrades, are factored into the facts and circumstances analysis under existing IRS guidance, the extension of the Continuity Safe Harbor in the Notice provides welcome certainty to developers and investors in offshore wind and federal land projects.

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