# IRS NOTICE 2018-59 CLARIFIES RULES ON BEGINNING OF CONSTRUCTION OF SOLAR FACILITIES TO QUALIFY FOR THE INVESTMENT TAX CREDIT

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**U.S. Tax Alert**

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On June 22, 2018, the U.S. Department of the Treasury ("Treasury") issued Notice 2018-59 (the "Notice"), which deals with the "begin construction" test that is applicable to solar projects. More specifically, the newly issued guidance clarifies the eligibility requirements applicable to the Investment Tax Credit ("ITC") claimed in connection with solar projects, closely following the "begin construction" guidance Treasury has previously issued for wind developers in order to determine eligibility for the production tax credit ("PTC"). You can read about previously published Treasury guidance in our prior e-alerts on this topic.

The Notice provides solar developers with long-awaited guidance on what constitutes the "begin construction" test in order for a solar project to qualify for the ITC equal to 30 percent. Similar to PTC guidance, the Notice provides two methods for determining when construction begins on solar projects: (1) the Physical Work Test and (2) the Five Percent Safe Harbor Test. Under the Physical Work Test, solar developers must show that physical work of a significant nature has begun. Under the Five Percent Safe Harbor Test, solar developers must show that at least 5 percent of the total cost of energy property has been paid or incurred. The Physical Work Test requires that a solar developer maintains a continuous program of construction, and the Five Percent Safe Harbor Test requires that the solar developer maintains continuous efforts toward completion of the solar project (collectively, the "Continuity Requirement").

A welcome safe harbor for satisfying the Continuity Requirement is provided by the Notice. If the solar project is placed in service by the end of the calendar year that is no more than four calendar years after the calendar year in which construction begins, the Continuity Requirement will be deemed to have been met. If this safe harbor is not met, a solar developer can still satisfy the Continuity Requirement (via the Physical Work Test or the Fiver Percent Safe Harbor Test) through facts and circumstances. Nonetheless, the governing statute stipulates that a project must be placed in service by the end of 2023 to qualify for the ITC at a rate higher than 10%, even if the four-year safe harbor described in the Notice has not yet elapsed.

Similar to PTC guidance, the Physical Work Test described in the Notice provides that whether physical work of a significant nature has begun depends on the relevant facts and circumstances and may include work performed by the taxpayer, work performed for the taxpayer by another person under a binding written contract, and work that occurs both on-site and off-site. As provided in the Notice, examples of on-site work that would qualify include:

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- Solar - installation of racks or other structures to affix photovoltaic panels, collectors, or solar cells to a site;
- Geothermal - physical activities that are undertaken at a project site after a valid discovery such as the installation of piping, turbines, generators, flash tanks, or heat exchangers; and
- Small wind energy - installation of the foundation, tower, wiring, or grounding systems.

For off-site work, physical work of a significant nature includes the manufacture of components, mounting equipment support structures such as racks and rails, inverters, transformers, and other power conditioning equipment. Similar to PTC guidance, physical work of a significant nature does not include the manufacturing of components that are in existing inventory or normally held in the inventory of a vendor.

The Notice also provides guidance on the types of activities that will not be taken into account for purposes of the "begin construction" test. For instance, physical work of a significant nature is limited to property that is considered integral to the production of electricity and does not include:

- Property used for transmission;
- Roads used to access the site or that are primarily used for employee or visitor vehicles;
- Buildings that are not functionally an item of equipment or do not house energy equipment and are expected to be removed when the energy property they house is removed; and
- Fencing.

In addition, preliminary activities such as planning or designing, securing financing, obtaining permits and licenses, or clearing a site, do not count for purposes of the "begin construction" test.

If a solar project that starts construction in 2018 or 2019 meets (A) either the Physical Work Test or the Five Percent Safe Harbor Test (as summarized above), and (B) the Continuity Requirement (as summarized above), and (C) the project is placed in service by December 31, 2023, then the project will qualify for the full ITC of 30 percent. The amount of the ITC that can be claimed decreases to 26 percent for projects that otherwise qualify and start construction in 2020 and 22 percent for projects that otherwise qualify and start construction in 2021.

Finally, similar to PTC guidance, the Notice clarifies that the taxpayer may transfer property after construction begins without jeopardizing eligibility for the ITC. Specifically, a solar developer can contribute a Physical Work or Five Percent Safe Harbor Test project to a tax equity partnership, a tax equity investor can acquire a membership interest in that partnership, and the partnership can claim the ITC based on the developer's prior ITC qualification when the project is placed in service. In addition, a purchaser of a partially developed solar project may tack on the developer's costs or work for purposes of the Physical Work or Five Percent Safe Harbor Test.

Despite this good news, unanswered questions remain. Namely, Treasury has yet to issue specific guidance regarding whether solar-plus-storage projects are eligible for the ITC. Although a series of published Private Letter Rulings have strongly suggested that storage projects that are part of a solar facility are eligible for the ITC, Treasury has yet to release any definitive guidance on this topic. It remains to be seen whether Treasury might include such guidance in any future revisions of the ITC Treasury Regulations or whether Congress might address the issue through legislation.

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