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IRS Tax Credit Guidance Should Break Wind Project Logjam

By **Keith Goldberg**

Law360, New York (August 12, 2014, 7:02 PM ET) -- The Internal Revenue Service's most recent attempt to clarify eligibility for the federal production tax credit for renewable energy projects should be enough to reassure skittish investors and break a gridlock of wind projects that have been stalled by uncertainty on whether they'd qualify for the credit, experts say.

The IRS on Friday issued updated guidance on the PTC, which expired at the end of the 2013. The guidance lays out what passes the "physical work" test the agency uses to determine what kind of construction needs to have been completed before 2014 to qualify for the credit, listing some qualifying examples: on-site excavation, roadwork or physical work on a custom-designed transformer that increases a facility's electric voltage. The work's price tag wouldn't be a factor, it says.

"This really clarifies things by underscoring that the physical work test is focused on the nature of the work rather than the amount of the work," said Mayer Brown LLP tax partner Jeff Davis, who co-heads the firm's renewable energy group. "That should break the logjam that has resulted from investors being reluctant to invest in projects where they may not have been confident that the developer's progress would satisfy the physical work test."

That bottleneck has been significant. More than 14,000 megawatts worth of wind projects that are under construction may be eligible for the PTC, according to the American Wind Energy Association, the U.S. industry's main trade group. And many of them, especially ones operated by smaller developers that don't have as much financial muscle, rely on the physical work test to qualify for the credit, experts say.

"There were many projects out there where there had been some work performed, but there wasn't any certainty as to whether it was enough," said David Lowman Jr., who co-chairs Hunton & Williams LLP's global renewable energy practice.

That uncertainty wasn't sitting well with tax equity investors, who resisted investing in such projects, bringing them to a standstill, experts say.

"Readings of the prior IRS guidance got to the point where the tax equity investor said, 'We're not investing until we can get more clarity,'" said Greg Jenner, a former head of the U.S. Department of the Treasury's office of tax policy who co-chairs Stoel Rives LLP's energy team. "It became clear [the IRS] had to do something, because the market was stuck."

While the physical work examples in the IRS guidance might not satisfy all investors, they're about as far as the agency could reasonably stretch, according to Keith Martin, the co-head of Chadbourne & Parke LLP's project finance group.

"The actual words of the notice seem clearly to be an effort by Treasury to say that not much had to be done in 2013 to qualify as physical work," Martin said.

Friday's guidance also says a partially developed facility can be transferred without losing eligibility as long as construction began before 2014. That's especially important because many wind energy projects are developed and then transferred just before they're put into service, experts say.

"There are lots of developers that have been looking at acquiring developments that smaller developers may have been working on but can't necessarily complete development or get financing," Martin said. "Knowing the PTC eligibility is safe is critical to moving those projects forward."

The guidance also expands safe harbor provisions to say that a taxpayer can qualify for the credit if it incurred project costs of at least 3 percent of the total facility cost before Jan. 1, within certain limitations. This is down from a previous 5 percent.

But experts say the physical work and transfer issues were the big points of contention for developers and investors.

Friday’s guidance is the IRS' third attempt in the past year and a half to clear up the eligibility requirements for the PTC after the industry and investors raised concerns.

In April 2013, the agency said projects would be eligible in 2014 for the credit if developers had started significant physical construction work or spent more than 5 percent of the project's total cost in 2013. Then the IRS modified the guidance in September, saying developers wouldn't have to show continuous efforts toward construction work after 2013 to stay eligible for the credit as long as the projects were in service by Jan. 1, 2016.

But experts believe Friday's guidance will be the agency's last word on the PTC eligibility issue.

"While there may be some lingering questions, I don’t expect Treasury is going to have the appetite to issue any more guidance," Davis said. "How many more times can the industry go back and say, 'We need further clarification'?"

Besides, the wind industry faces a more pressing issue, experts say: reviving the PTC itself. Since it was first enacted in 1992, the credit, which has been a boon to the growth of the U.S. wind industry, has expired five times, only to be brought back from the dead and temporarily extended. But that effort has struggled to get traction in Congress this year.

"The focus now is going to be on an extenders bill and potential action in the lame-duck section of Congress," Lowman said.

In the meantime, experts believe the updated guidance from the IRS will help reopen the tax equity investment spigot, putting more stalled wind projects back on the road to development and completion and injecting life into a sluggish U.S. wind market. The wind industry installed only 835 megawatts of wind power in the first half of 2014, according to the AWEA, which lags behind historical norms.

"I expect the remainder of this year is going to be quite busy," Davis said. "There will be a flurry of activity."

--Additional reporting by Tom Zanki. Editing by Kat Laskowski and Katherine Rautenberg.
