

IRS Continuity Safe Harbor Will Aid Renewable Projects

By **Jeffrey Davis, George Haines and Isaac Maron** (January 13, 2021)

On Dec. 31, 2020, the U.S. Department of the Treasury and the Internal Revenue Service issued Notice 2021-05, which provides relief for offshore renewable energy projects and renewable projects constructed on federal land.[1]

Specifically, the notice allows the continuity safe harbor — defined below — to be satisfied for projects constructed offshore or on federal land if they are placed into service no more than 10 calendar years after the calendar year during which construction began.

This relief is expected to provide additional certainty for taxpayers developing projects offshore or on federal land, given the significant construction delays often associated with such projects.

Background

Under Section 45 of the Internal Revenue Code, qualified facilities, including wind power projects, are eligible for a production tax credit for electricity produced and sold to an unrelated person. Under Section 48 of the code, solar power projects — and electing wind power projects — are eligible for an investment tax credit, determined as a percentage of the basis of energy property placed in service. Both the investment tax credit and production tax credit are subject to phaseout based on the date that construction begins on a project.

Recently, the Taxpayer Certainty and Disaster Tax Relief Act of 2020, or Relief Act, enacted as Division EE of the Consolidated Appropriations Act of 2021,[2] extended certain deadlines for beginning of construction with regard to the investment tax credit and the production tax credit.

In the case of the investment tax credit, the Relief Act extended the deadline for a 26% investment tax credit from Dec. 31, 2020, to Dec. 31, 2022 — with a 22% investment tax credit available for projects that begin construction by Dec. 31, 2023. For the production tax credit, the act extended the deadline for 60% of the credit — 0.9 cents per kilowatt-hour — from Dec. 31, 2020, to Dec. 31 of this year.

Additionally, the Relief Act further relaxed these deadlines for qualified offshore wind facilities, including wind farms that are located in the inland navigable waters or the coastal waters of the U.S., allowing such facilities to elect either the production tax credit or the investment tax credit, with a full 30% investment tax credit available for offshore wind farms that begin construction by Dec. 31, 2025, with no phaseout.

Under Notice 2013-29,[3] the IRS provided two methods for establishing the date that a project begins construction: the physical work test and the 5% safe harbor. Under each of these methods, IRS guidance generally requires that a wind or solar project be placed in service within four calendar years after the year in which construction of the project began — the continuity safe harbor — in order to avoid having to demonstrate continuity using facts and circumstances.[4]



Jeffrey Davis



George Haines



Isaac Maron

Absent the continuity safe harbor, a taxpayer would be required to satisfy a facts-and-circumstances test to demonstrate either a continuous program of construction (in the case of the physical work test) or continuous efforts toward completion (in the case of the 5% safe harbor), a test that could be difficult to satisfy and that could make a project difficult to finance.

Although the IRS guidance makes allowances for certain excusable disruptions with respect to the facts-and-circumstances test, these allowances do not apply to the continuity safe harbor.

The Problem for Offshore Wind

In the notice, in response to comments from Congress and stakeholders, the IRS noted that renewable projects constructed offshore or on federal lands are subject to significantly greater delays than similar projects not constructed offshore or on federal land, as a result of stricter permitting requirements, the difficulty of installing equipment offshore, heightened environmental regulation and the need to construct new transmission lines to connect the projects to the U.S. electrical grid system.

The IRS observed that these delays are ordinarily outside the control of project developers and can result in project completion times of up to twice as long as those of similar projects not constructed offshore or on federal land.

The unique challenges of developing such projects have been presented in the permitting delays for Vineyard Wind LLC, an 800 megawatt offshore wind farm located off the coast of Martha's Vineyard, Massachusetts. Vineyard Wind was expected to be the first utility-scale offshore wind farm in the U.S., but has been subject to prolonged permitting delays due to the Bureau of Ocean Energy Management's unexpected decision in 2019 to expand its review of the environmental impacts of the project to include a more robust analysis of the potential cumulative impact of offshore wind farm development in the northeast region.

In late 2020, Vineyard Wind announced that it was switching from Vestas turbines to GE turbines, and temporarily withdrew its construction and operations plan from review by the BOEM, a decision that is expected to further delay the permitting process.

Although the delay of Vineyard Wind has garnered the most attention, it is not alone. Orsted, for example, announced in 2020 that four of its U.S. offshore development projects are moving at a slower pace than originally projected as a result of the BOEM's analysis of the cumulative impacts from the build-out of U.S. offshore wind projects.

As an illustration of the current permitting timeline, Dominion Energy Inc. submitted a construction and operations plan to the BOEM at the end of 2020 for a 2.6 gigawatt offshore wind project off the coast of Virginia and BOEM's review is expected to take approximately two years.

The Relief in the Notice

In light of these potential delays and the fact that existing relief for excusable disruptions does not apply to the continuity safe harbor, the notice allows the continuity safe harbor to be satisfied for projects constructed offshore or on federal land if they are placed into service no more than 10 calendar years after the calendar year during which construction began.

This relief applies to offshore projects and federal land projects. Offshore projects include qualified facilities or energy property construction projects that will (1) be placed in service in inland navigable waters or coastal waters of the U.S. and (2) require the construction of one or more high-voltage transmission lines to connect the qualified facility or energy project to the U.S. electrical grid system.

Federal land projects include qualified facilities or energy property construction projects that will (1) be more than 50% placed in service on federal land, as determined by relative value or relative area, and (2) require the construction of one or more high-voltage transmission lines to connect the qualified facility or energy project to the U.S. electrical grid system.

Conclusion

The Relief Act and the notice will be welcomed by developers and investors contemplating offshore wind projects and projects on federal land, given the higher likelihood of project delays and accordingly higher risk of failing to satisfy the general continuity safe harbor.

Jeffrey Davis is a partner, and George Haines and Isaac Maron are associates, at Mayer Brown LLP.

Mayer Brown partner Daniel Kiely contributed to this article.

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[1] Available at <https://www.irs.gov/pub/irs-drop/n-21-05.pdf>.

[2] Pub. L. No. 116-260 (Dec. 27, 2020). For our previous coverage of the investment tax credit and production tax credit implications of the Relief Act, see https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/12/solar-and-wind-tax-credits-extendedagain_1220_v1.pdf.

[3] 2013-20 I.R.B. 1085.

[4] The IRS guidance on the continuity safe harbor established by Notice 2013-29 has been updated on several occasions, but the guidance generally retains the four-year framework for the safe harbor. Recently, in response to the COVID-19 pandemic, the IRS extended the safe harbor to five years for facilities or energy property that began construction in 2016 or 2017.