

New IRS Guidance on the Investment Tax Credit

Overview

On Friday, June 22, 2018, the Internal Revenue Service (IRS) released long-awaited “commence construction” guidance, addressing when a solar project has started construction for purposes of the Section 48 Investment Tax Credit (ITC). This guidance, which is similar to that provided for wind generators in 2013, will drive additional deployment and investment in solar energy by providing certainty to investors and developers that was previously lacking. However, to take advantage of the 30 percent, 26 percent or 22 percent ITC, a project must be placed in service before January 1, 2024. This allows for a four, three, and two-year window respectively, after construction has commenced to place qualified property in service. This clarity creates the certainty needed for the solar industry to take full advantage of the valuable ITC and extends the benefits of the higher tax credit beyond 2021.

IRS [Notice 2018-59](#) establishes two methods for a taxpayer to demonstrate that a project has begun construction, reflecting the same approach used in the analogous guidance for the wind credit. The guidance defines both a “significant work test” and a “five percent safe harbor” test and requires the taxpayer to make continuous progress (defined differently for each test) until the project is completed. However, no proof of continuous work is required for a project completed within four years.

IRS Guidance Details

Applicability – The IRS guidance applies to qualified energy property as defined by the § 48 ITC. In addition to solar, this includes fuel cells, small CHP projects, geothermal heat pumps and small distributed wind farms.

- **Commence Construction** – The IRS guidance provides two different methods a taxpayer can use to demonstrate the commencement of construction of an eligible project:
 - **Physical Work Test.** Construction has started when “physical work of a significant nature begins.” The IRS will focus on the “nature of the performed work, not the amount or the cost.” Furthermore, IRS states “there is no fixed minimum amount of work or monetary or percentage threshold required” to satisfy the test. The work can include both off-site and on-site work, but work cannot begin until a binding contract is in place to have the work done. For a list of examples of “significant work” see pages 12-14 of [Notice 2018-59](#).
 - **Five Percent Safe Harbor Test.** A taxpayer can demonstrate that construction has commenced when he/she pays or incurs five percent or more of the total cost of the energy property. Costs are considered “incurred” typically when a service or good has been delivered and must be integral to generating electricity. All costs that are properly included in the depreciable basis of the energy property are taken into account to determine whether the five percent test has been met. If the project later exceeds projected amounts, and the expenses occurred in the year the

tax incentive is sought are below five percent, the taxpayer loses the ability to claim that start construction date.

- Continuous Work** – Once either test has been met, there must be continuous work on the project until it is placed in service. **However, the IRS has indicated that it will not require proof of continuous work if a project is completed within four years.** If continuous work is required to be demonstrated, the proof needed to show continuous work depends on which start construction test is used. Taxpayers that used the Physical Work Test must demonstrate continuous physical work, and those that use the Five Percent Test only need to demonstrate continuous effort. Delays that are out of the control of the taxpayer will be excused. However, any projects claiming the 30 percent, 26 percent, or 22 percent ITC must be placed in service before 2024; therefore, only projects that commence construction before January 1, 2019 may be required to show proof of continuous work.

		Commence Construction Date				
		2018	2019	2020	2021	2022
Place In Service	2018	30%	-	-	-	-
	2019	30%	30%	-	-	-
	2020	30%	30%	26%	-	-
	2021	30%	30%	26%	22%	-
	2022	30%	30%	26%	22%	10%*
	2023	30%	30%	26%	22%	10%*
	2024	10%*	10%*	10%*	10%*	10%*

Requires proof of continuous work

* The 10% ITC is a permanent tax credit that is only available for non-residential projects

December 31, 2023 Deadline for ITC/PTC above 10%

Conclusion

The IRS guidance provides market certainty that will help drive investment in deployment in solar energy. The ability to claim a higher tax credit earlier on in the construction process opens up a window for more projects to take advantage of the tax incentive. However, the requirement that any project claiming the 30 percent, 26 percent, or 22 percent ITC be placed in service by December 31, 2023 limits the benefits of this window.