

Good News for Solar and Other ITC Projects

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Summary

The IRS released Notice 2018-59 on June 22, providing guidance to taxpayers on how to begin construction on solar and other renewable energy projects. It provides a 4 year safe harbor period for solar projects to be placed in service after construction has been deemed to have begun. The notice borrows heavily from the beginning of construction tests set forth in the prior notices while also clarifying a few open issues and providing solar-specific guidance.

In Depth

On June 22, 2018, the Internal Revenue Service (IRS) released Notice 2018-59 (the Notice) providing taxpayers with guidance on how to “begin construction” on solar and other renewable energy projects eligible for the investment tax credit under IRC §48 (ITC). The Notice is especially helpful in that it provides a 4 year safe harbor period for solar projects to be placed in service after construction is deemed to have begun. The significance of this safe harbor period is that taxpayers will be able to purchase equipment equal to 5 percent of anticipated project costs in 2019 to permit projects placed in service through 2023 to qualify for the ITC at the current 30 percent rate.

Previously, the IRS had issued several notices addressing the beginning of construction requirements for wind and other production tax credit (PTC) eligible facilities (including biomass, geothermal, landfill gas, trash, hydropower and marine and hydrokinetic facilities) (Notice 2013-29, Notice 2013-60, Notice 2014-46, Notice 2015-25, Notice 2016-31, and Notice 2017-4, the “Prior Notices”). [To read more on these notices, see [IRS Issues Additional Guidance on Beginning of Construction Rules for Renewable Projects](#).] The Notice borrows heavily from the beginning of construction tests set forth in the Prior Notices while also clarifying a few open issues and providing guidance specific to solar.

Background on ITC Beginning of Construction Dates. The ITC for solar is equal to 30 percent of the basis of qualifying solar property, if construction on such property begins before January 1, 2020. The ITC is reduced to 26 percent for solar projects beginning construction in 2020, and is further

reduced to 22 percent for solar projects beginning construction in 2021. Solar projects beginning construction in any of these years must be placed in service prior to January 1, 2024, to be eligible for these ITC percentages. Solar projects placed in service after January 1, 2024, are eligible for a 10 percent ITC.

Pursuant to the Bipartisan Budget Act of 2018, fiber-optic solar, qualified fuel cell and qualified small wind projects are likewise eligible for the 30 percent, 26 percent and 22 percent ITC so long as projects begin construction prior to January 1, 2022, and are placed in service by January 1, 2024. See [Neglected Renewables Get Another Shot in Budget Bill](#). However, these projects are ineligible for the ITC if placed in service on or after January 1, 2024. In addition, combined heat and power and geothermal heat pump projects that begin construction prior to January 1, 2022, are eligible for the ITC regardless of their placed in service dates; however, no ITC is available for combined heat and power or geothermal heat pump projects beginning construction after this date.

Beginning Construction under the Notice. The Notice provides guidance on how to begin construction for solar, fiber-optic solar, fuel cell, small wind, combined heat and power, and geothermal heat pumps (collectively, energy property) to qualify for the ITC. As in the Prior Notices and the US Treasury's 1603 Grant program, there are two methods available for beginning construction on energy property: performing physical work of a significant nature (Physical Work Test) and paying or incurring 5 percent or more of total energy property costs (5% Safe Harbor).

The Notice is clearer than the Prior Notices as to when energy property is deemed to have begun construction if efforts are made over several years to construct a project, by clarifying that construction is deemed to have begun on the date the taxpayer first satisfies one of the two methods. An example in the Notice provides that if a taxpayer meets the Physical Work Test in 2018 and the 5% Safe Harbor in 2019, construction will be deemed to have begun in 2018. However, the Notice provides that this rule applies to energy property the construction of which begins *after* December 31, 2018. It is unclear whether this date was meant to be December 31, 2017, or whether taxpayers can continue to look to the last method used prior to December 31, 2018, as the start of construction date. We would assume the former based on past guidance but that is not how the Notice reads. Either way, this rule is important to determine the appropriate period for meeting the Continuity Requirement (defined below). The Notice also confirms the understanding of many taxpayers that, despite the Prior Notices' limited prohibition against *alternating* the two construction methods, the earliest beginning of construction date is the date that governs, regardless of whether methods are alternated.

After taxpayers meet the Physical Work Test or the 5% Safe Harbor, as in the Prior Notices, taxpayers must make continuous progress towards completion (Continuity Requirement). Whether a project meets the Continuity Requirement is a facts and circumstances test. The Notice sets forth a list of activities that qualify for purposes of meeting the Continuity Requirement, but it is often unclear whether a project has met this requirement because projects can encounter various delays or perform activities that do not clearly fit within the enumerated activities. Helpfully, the Notice provides a safe harbor for meeting the Continuity Requirement (Continuity Safe Harbor). Under the safe harbor, if a taxpayer places energy property in service by the end of a calendar year that is no more than four calendar years after the calendar year in which construction of the energy property began, the energy property is deemed to have satisfied the Continuity Safe Harbor.

In our experience, taxpayers have more frequently used the Continuity Safe Harbor as a means of meeting the Continuity Requirement than relying on facts and circumstances because it is an objective test. The Notice's clarification that this test applies to solar and other ITC projects is helpful

and will provide several years of certainty for solar projects post-2019, particularly for residential, commercial and industrial projects, which have shorter construction periods. Because the Continuity Safe Harbor is tied to the date a taxpayer first satisfies either the Physical Work Test or 5% Safe Harbor, taxpayers must carefully determine the earliest date on which construction began.

The Physical Work Test and Safe Harbor generally mirror the same tests from the Prior Notices, although the Notice provides some additional examples applicable to solar and other energy property. With respect to the Physical Work Test, the Notice provides examples of off-site physical work of a significant nature, such as the manufacture of mounting equipment, support structures such as racks and rails, inverters and transformers that step up voltage to less than 69 kilovolts and other power conditioning equipment. The Notice also provides a non-exclusive list of examples to illustrate on-site physical work of a significant nature for different types of energy property:

- Solar Energy Property: installation of racks or other structures to affix photovoltaic (PV) panels, collectors, or solar cells to a site.
- Fiber-Optic Solar Energy Property: installation of collectors, concentrators, tracking systems, bundles of optical fibers, or fixtures within a structure.
- Geothermal Property: 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.
- Qualified Fuel Cell Property: installation of components of a fuel cell stack assembly such as electrodes, gas diffusion layers, membranes, gasketing or plates.
- Qualified Microturbine Property: installation of a gas turbine engine, combustor, recuperator, regenerator, generator, alternator or other plant components.
- CHP Property: installation of a heat engine, generator, heat recovery components or electrical interconnections.
- Qualified Small Wind Energy Property: installation of a foundation, tower, wiring or grounding systems.
- Geothermal Heat Pump Property: installation of ground heat exchangers, heat pump units or air delivery systems (ductwork).

The Notice also lists preliminary activities that do not qualify as physical work of a significant nature, which activities mirror those listed in the Prior Notices, although the Notice adds the clarification that the preliminary activity of conducting test drilling to determine the soil condition also includes such activities to test the strength of a foundation. The Notice, like Prior Notices, sets forth a non-exclusive list of excusable construction disruptions for purposes of the Continuity Requirement. The list of disruptions is the same as in Prior Notices (see [Notice 2016-31](#)) but clarifies that interconnection-related delays include construction on a new distribution line (rather than just on new transmission) and distribution upgrades (rather than just on transmission upgrades). In the case of a single project comprised of a single energy property, whether an excusable disruption has occurred is determined in the calendar year during which the energy property is placed in service. In the case of a single project comprised of multiple energy properties, whether an excusable disruption has occurred is

determined in the calendar year during which the last of multiple energy properties is placed in service.

The Notice defines energy property in the same manner as Prior Notices, except that it clarifies that if equipment is an addition or modification to an energy property, it is not required to be functionally interdependent with other components. The Notice then defines energy property more clearly for solar equipment specifically. It provides that energy property is comprised of all components of property necessary to generate electricity up to and including the inverter. Additionally, the Notice provides that, for rooftop solar energy property, property integral to the generation of electrical energy that is installed on a single rooftop is considered a single unit of property. Under the 1603 Grant program, applicants had questioned whether a single unit of property on a rooftop system might include all panels attached to a single inverter for rooftop projects with multiple inverters. However, the Notice seems to preclude taxpayers from taking that position for beginning of construction purposes. This is helpful, as it allows taxpayers to consider the rooftop system as a single unit for purposes of the 5% Safe Harbor and Physical Work Test, and potentially harmful, because if rooftop solar is a single unit, it cannot be “disaggregated” if the 5% Safe Harbor is not met for that unit; if that is the case, the entire system is ineligible for the ITC for the 5% Safe Harbor year).

Conclusion

The Notice ensures that solar projects and other energy property will likely continue to qualify for the 30 percent ITC for several years beyond 2019. It is a welcome development for investors and developers and will likely lead to many equipment purchases in 2019 to qualify future projects for the 5% Safe Harbor.

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National Law Review, Volume VIII, Number 180

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