

Recent Tax Developments Affecting Alternative Energy Transactions: Extension of Continuity and Five Percent Safe Harbor Under IRS Notices

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In response to the economic disruptions that have resulted from the COVID-19 pandemic, on May 27, 2020, the IRS issued [Notice 2020-41](#) to extend the continuity and five percent safe harbor under previously issued IRS guidance relating to solar and wind projects.

Under the previous IRS guidance, a taxpayer is treated as having begun construction on a project by starting physical work of a significant nature (physical work test) or, alternatively, by incurring five percent or more of the total cost of the facility or property (five percent safe harbor). To qualify under the physical work test or the five percent safe harbor, the taxpayer also must make continuous progress towards completion of the facility once construction has begun (continuity requirement). Under the previous IRS guidance, a taxpayer was deemed to satisfy the continuity requirement if the taxpayer placed a facility in service by a calendar year that is no more than four calendar years after the calendar year during which construction of the facility began (continuity safe harbor). Notice 2020-41 provides a one-year extension of the continuity safe harbor for projects that started construction in 2016 or 2017.

In addition, the Notice modified the five percent safe harbor. The five percent safe harbor treats construction as beginning with respect to any qualified facility or energy property when the taxpayer pays or incurs five percent of total project costs. Generally, such costs are not deemed to be incurred for tax purposes until the relevant services or property are provided to the taxpayer. Existing Treasury regulations have a three-and-a-half-month rule under which expenses may be treated as being incurred at the time of payment if the property or services are reasonably expected to be provided within three-and-a-half-months of payment. Thus, expenses may be deemed to be incurred in 2019, even though property or services are not delivered until early 2020. For example, in an effort to meet the five percent safe harbor and grandfather projects at the 2019 ITC rate, many equipment supply contracts were entered into at the end of 2019 for equipment to be delivered in early 2020.

Notice 2020-41 provides a new safe harbor for satisfying the requirement that property must be expected to be received within three-and-a-half-months of payment. Under the new safe harbor, for services or property paid for by the taxpayer on or after September 16, 2019, the taxpayer will be deemed to satisfy the three-and-a-half-month requirement if the services or property are actually received by October 15, 2020. Even if this new safe harbor is not met, the taxpayer may still rely on the “reasonable expectations test,” which means that the taxpayer may still

argue that it reasonably expected to receive equipment within three-and-a-half-months of payment, even if actual receipt of the property occurs after October 15.

For more information, please contact one of the authors of this alert, or your usual Winston relationship attorney.

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