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Renewable Energy Projects on Federal Land: Regulatory Challenges, PTC and ITC Safe Harbors, Financing, Permitting

Recent IRS Extensions and Guidance, Beginning of Construction Under Sections 45 and 48,
Key Issues for Developers and Investors

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Renewable Energy Projects Development on Federal Public Land: Regulatory Challenges, PTC & ITC Safe Harbors, Financing, Permitting



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Introduction

- Federal Tax Credits
 - Section 45 – Production Tax Credit (PTC)
 - Tax credit for each kWh of electricity that is (i) produced from a qualified energy resource at a qualified facility and (ii) sold to an unrelated third party during that taxable year
 - 10-year tax credit period
 - Wind, biomass, municipal waste, landfill gas, incremental hydro, marine
 - Section 48 – Investment Tax Credit (ITC)
 - Tax credit calculated as a percentage of the tax basis of each energy property placed in service during that taxable year
 - Solar, fuel cells, geothermal, CHP, small wind, fiber-optics solar
 - 50% basis reduction for ITC claimed
 - 5-year recapture period
 - Most PTC projects can elect to claim the ITC in lieu of the PTC.
 - Overview
 - Why Projects on Federal Lands/Offshore are Different
 - Tax Credits – Begin Construction and continuity Safe Harbor
 - BLM, BIA and Offshore Projects

Renewed Focus on Federal Land Opportunities

- **BLM jurisdiction over 245 million acres mainly in 11 Western States**
 - Wind Projects – 40 projects at 5.6GW (2020)
 - Continued growth over past four decades
 - Solar Projects – 25 projects at 6.3GW (2018)
 - Significant growth starting circa 2010 with State RPS, ARRA, ITC
- **Political Influence over Public Land Policies and Priorities**
- **Renewed Opportunities for Public Lands Projects**
 - Constraints on private land – size, location and existing uses
 - Increased government and C&I focus on clean energy investment
 - Planning and policy framework now in place
- **Offshore**
 - Significant eastern seaboard and west coast opportunities
- **Need for IRS Guidance**
 - Development, permitting and construction timelines did not fit within current 4 year framework

PTC – Wind Phase Out

- The PTC was set to expire for wind projects that did not “begin construction” prior to January 1, 2020
- The PTC for Wind has been extended twice since the phase out was adopted
 - Projects that began construction before the end of 2016 – 100%
 - Projects that began construction in 2017 – 80%
 - Projects that began construction in 2018 – 60%
 - Projects that began construction in 2019 – 40%
 - Projects that begin construction in 2020 – 60%
 - Projects that begin construction in 2021 – 60%
 - Projects that begin construction after 2021 – 0%

Other PTC Extensions

The Taxpayer Certainty and Disaster Relief Act also extended the PTC and ITC, in lieu of PTC, for the following technologies, which projects must begin construction by the end of 2021 to qualify:

- Closed-loop biomass
- Open-loop biomass
- Geothermal energy
- Landfill gas
- Municipal solid waste
- Incremental hydropower
- Marine and hydrokinetic renewable energy

PTC in lieu of ITC for Wind Projects

Section 48 allows certain projects to elect ITC in lieu of PTC

ITCs for wind projects – phase out

- Projects that began construction before the end of 2016 – 30% ITC
- Projects that began construction in 2017 – 24%
- Projects that began construction in 2018 – 18%
- Projects that began construction in 2019 – 12%
- Projects that begin construction in 2020 – 18%
- Projects that begin construction in 2021 – 18%
- Projects that begin construction after 2021 - zero

ITCs in lieu of PTCs for offshore wind projects – no phase out

- Projects that began construction before January 1, 2026 – 30%
- Projects that begin construction after 2025 - zero

Solar ITC Extension

- The phase out of the ITC for Solar projects has also been extended.
- Previously, the 26% ITC for Solar projects was set to step-down at the end of 2020 to 22% for projects that have not begun construction. The 2-year extension maintains the 26% ITC for Solar projects that begin construction in 2021 or 2022.
- Now the ITC phasedown schedule is as follows:
 - Projects that began construction before the end of 2019 – 30% ITC
 - Projects that begin construction in 2020 – 26% ITC
 - Projects that begin construction in 2021 – 26% ITC
 - Projects that begin construction in 2022 – 26% ITC
 - Projects that begin construction in 2023 – 22% ITC
 - Projects that began construction in 2024 or after – 10% ITC
- To qualify for the 30 percent, 26 percent or 22 percent ITC, the solar project must be placed in service before Jan. 1, 2026. If the solar project is placed in service on or after Jan. 1, 2026, the project is only eligible for the 10% ITC.

Begin Construction Requirements

The Tax Code requires a project “begin construction” by a certain date to qualify for the applicable PTC or ITC

- Wind - The IRS issued a lineage of “Begin Construction Notices” starting with IRS Notice 2013-29 and through IRS Notice 2019-43 (the “Wind Notices”)
- Solar - The IRS issued Notice 2018-59 (the “Solar Notice”) regarding beginning construction of solar projects
 - The Solar Notice largely follows the Wind Notices

Start project construction by the deadline either with:

- Physical Work Test – “Physical work” of a “significant nature” on property that is “integral” to the project’s energy generating equipment must “start” by the deadline
- Or
- 5% Safe Harbor - The taxpayer must “pay” or “incur” “at least 5%” of the “eligible project costs” by the deadline

Physical Work Test

- “Physical work” of a “significant nature” on property that is “integral” to the project’s energy generating equipment must “start” by the deadline
- Both onsite work and offsite work can qualify as physical work integral to the project
 - But, offsite physical work does not count
 - if it is on property normally held in inventory by the vendor or
 - if the work begins, or payment is made, before a “binding written contract” is entered into by the parties
- Physical work means manufacturing, constructing, assembling, excavating

Physical Work Test – What is Significant

- “Physical work” of a “significant nature” on property that is “integral” to the project’s generating equipment must “start” by the deadline
- Work is of a significant nature if it is qualitatively significant. The test focuses on the “nature of the work performed, not the amount or the cost”
- There is no dollar minimum in the guidance. There may be a dollar minimum imposed by investors
- There is no requirement that the physical work be of any minimum amount (technically). Goes to the nature of the work completed before the deadline
 - Supporting documentation could become important. Manufacturing logs, IE reports/certificates and pictures might be a requirement of investors
 - Investors may also look at the amount of man-hours spent to get comfortable
- Work must be on property that is “integral” to the project’s generating equipment
- Only work that is on the generating equipment or work necessary for the generating equipment to function counts

Physical Work Test – IRS Examples of Significant Work

- The IRS Guidance provides a “non-exclusive” lists of onsite and offsite work that it views as being work of a “significant nature”
- **Wind Notices**
- Onsite “significant” work includes (1) “excavation for the foundations”, “setting of anchor bolts” or “pouring of concrete pads of the foundations”. (2) work on operation and maintenance roads (not access or visitor parking roads) and (3) buildings/structures that are essentially an item of equipment or a building/structure integral to the energy property and that cannot be economically used for another purpose
- Offsite “significant” work includes “physical work on a custom designed transformer”. Must be manufactured under a binding contract and not in inventory
- **Solar Notice**
- Onsite “significant” work includes (1) “installation of racks or other structures” to affix panels, collectors or solar cells, (2) work on operation and maintenance roads (not access or visitor parking roads) and (3) buildings/structures that are essentially an item of equipment or a building/structure integral to the energy property and that cannot be economically used for another purpose
- Offsite “significant” work includes manufacturing of components, mounting equipment, support structures, racks, rails, inverters and custom designed step up transformers. These components must be manufactured under a binding contract and not in inventory

Physical Work Test – Work that Does Not Count

Work that does not count towards “physical work” of a “significant nature” on property that is “integral” to the project

- Work on transmission assets does not count
- The IRS says fencing does not count
- Physical work does not mean “preliminary activities” such as design, planning, studies, securing financing, getting permits, performing tests on the land or resource, clearing the site, contouring land or removing old foundations

Physical Work Test – Start Construction

- “Physical work” of a “significant nature” on property that is “integral” to the project’s solar generating equipment must “start” by the deadline
- There is no requirement that the work continue on once it starts, as long as the project is finished by the end of the fourth year after construction started (continuity test safe harbor)
 - If you start work on a transformer, for example, by the deadline and the work stops for one or more years, that is not a problem as long as the project is placed in service by the deadline under the continuity test
 - If it is not placed in service by that deadline, the project owner will have to prove physical work was continuous, which may be difficult, as a general rule

5% Safe Harbor

- The taxpayer must “pay” or “incur” “at least 5%” of the “eligible project costs” by the deadline
 - Cash basis taxpayers have to pay at least 5% by the deadline
 - Accrual basis taxpayers have to incur at least 5% by the deadline
 - “Pay” – actual cash out the door. Not a payment made with money loaned to the buyer by the seller of equipment
 - Just getting an invoice is not a payment
 - Refundable deposit is not payment
 - “Accrual” – All events have occurred that fix the amount and make it due (perhaps with the passage of time) AND economic performance has occurred
 - Economic performance occurs when the item is delivered, title passes or the item is accepted, with one major exception
 - If the taxpayer pays for the equipment by the deadline and reasonably expects delivery, title or acceptance within 3.5 months of the payment date, the payment date can count as economic performance occurring
 - IRS Notice 2020-41 provides a safe harbor for costs paid or incurred on or after September 16, 2019, in that the 3.5 month rule is deemed satisfied if the property or services are received by the taxpayer no later than October 15, 2020

5% Safe Harbor – Calculation of 5%

- The taxpayer must “pay” or “incur” “at least 5%” of the “eligible project costs” by the deadline
 - The test looks to at least 5% of the aggregated cost of the project . If you are at 4.99%, you haven’t met the test
 - As with the physical work test, project costs only look to costs of the generating equipment, plus other integral equipment. It does not include land costs or transmission costs (including network upgrades behind the interconnect). It does include “soft” costs related to the costs of equipment, such as legal expenses relating to the purchase of equipment
 - The IRS permits a project to be broken down into units. If the actual costs incurred are more than expected, the IRS has said that the taxpayer can carve units off of the project and claim the ITC or PTC on a smaller project if needed in order to meet the 5% test

5% Safe Harbor – Practical Considerations

- The taxpayer must “pay” or “incur” “at least 5%” of the “project costs” by the deadline
 - Disregarded entities do not have a method of accounting for federal tax purposes, the taxpayer is the first regarded entity in the upstream ownership chain
 - Developers or sellers of projects relying on the 5% Test should be prepared to disclose information of the ultimate regarded taxpayer to determine the appropriate method of accounting
 - May need to allocate part of the contract price to other services or equipment if the contract is for more than just a single piece or type of equipment or includes non-incidental services that have not yet been performed
 - “Binding written contract” requirements apply, but the components can be held in the manufacture's inventory for purposes of the 5% Test
 - Make sure contract is in the name of the proper taxpayer, or its disregarded entity, and that payment is made by the same party. Avoid later clean-ups
 - Consider inspections at time of delivery, pictures of equipment, bi-laterally executed acceptance documents and other documentation to support the date equipment is delivered
 - Keep good payment / invoice records

Continuity Requirement & Continuity Safe Harbor

- Once Begun, Must Continue. Once construction starts, it must be continuous until the project is placed in service, either by (i) maintaining a “continuous program of construction” (in the case of work of a physical nature), or (ii) making “continues efforts” to complete the project (in the case of utilizing the 5% safe harbor)
- Presumption of Continuity. The IRS provides a presumption of continuity as long as the project is finished by the end of the fourth (4th) year after the year project first starts construction
- Facts & Circumstances If Outside Safe Harbor. If you are outside of the four (4) year period, you have to prove you were continuous and that will be very tough, given conservative financing parties.
- COVID - Extension of Safe Harbor Window. IRS Notice 2020-41 extended the four (4) year continuity by one (1) year for projects that began construction in either 2016 or 2017
- Beware of Placed in Service Deadlines. In addition to the continuity requirement, solar projects must be placed in service by the end of 2026 to claim the 30%, 26% or 22% ITC rather than the reduced 10% ITC. The 4 year continuity safe harbor does not extend that deadline
- No Switching Methods Allowed. You may not switch between methods (5% one year and physical work the next year or vice versa) in order to extend the four year period

Transfers

- Project Transfers - Third Parties. Once construction starts, the project may be transferred to a third party, but such transfer must include assets other than just tangible personal property
 - The transferee “steps into the shoes” of the taxpayer that safe harbored the project
 - The transferor need not retain any interest
- Tangible Property Transfers - only to Related Parties. Safe harbored equipment can be transferred by itself, without a project or other assets, only to a “related party” (>20% of capital or profits) or transferred to another project of a developer without the requirement for inclusion of other non-tangible personal property
 - A developer that has a stockpile of grandfathered equipment may sprinkle the equipment down to various projects it owns
 - Developer partnerships are becoming more common to bring grandfathered equipment to a more viable project
- Undefined Projects Okay. The projects do not need to be pre-defined when the equipment is purchased, under the master agreement rule
- Use of Grandfathered Equipment. The developer may acquire a project after the deadline and incorporate its grandfathered equipment into that project

IRS Recognition of Greater Delays for Construction of Projects Offshore and on Federal Land

- **IRS Acknowledgement of Need for Guidance**

- In IRS Notice 2021-05, the IRS acknowledged that renewable energy projects constructed Offshore or on Federal Land are subject to greater delays and thus are at a significantly higher risk of failing the Continuity Safe Harbor.

- **Common Delays and Complicating Factors** for such Projects include the following:

- Stricter Permitting Requirements – the applicability of significantly more stringent permitting requirements (NEPA);
- Lengthier engineering and construction timelines - due to, for example, the difficulty of installing equipment Offshore;
- Heightened environmental regulation - including, for example, the environmental analysis process carried out by the Director of the Bureau of Land Management;
- Need for Constructing New Transmission Lines - to connect these projects to the electrical grid

- **Outside of the Control of the Project Developers**

- Such delays ordinarily are outside the control of the project developers and can result in project completion times of up to twice as long as those experienced by qualified facility and energy property projects that are not constructed Offshore or on Federal Land.

IRS Notice 2021-05 - Extension of Continuity Safe Harbor

- **10-Year Continuity Safe Harbor for Offshore and Federal Land Projects**
 - A qualified facility or an energy property construction project that is an Offshore Project or a Federal Land Project satisfies the Continuity Safe Harbor if a taxpayer places the qualified facility or energy property that is the subject of the project into service by the end of a calendar year that is no more than 10 calendar years after the calendar year during which construction of the project began.
- **Offshore Project.**
 - An “Offshore Project” is a qualified facility or an energy project construction project that will be placed in service Offshore.
 - For these purposes, “Offshore” means any inland navigable waters of the United States or coastal waters of the United States.
- **Federal Land Project.**
 - A “Federal Land Project” is a qualified facility or an energy property construction project (a) more than 50% of which will be placed in service on Federal Land; and (b) that will require the construction of one or more high-voltage transmission lines to connect the qualified facility or energy property to the Grid.
 - For these purposes, “Federal Land” means any land owned or controlled by the United States.

Developing Federal Lands and Offshore Projects

- **Unique Projects**

- Developers and the US Government must work together
- Tribes and States are also involved for projects on Indian land or Offshore (i.e., interconnection point)

- **Development Timelines are Longer than Projects on Private Lands**

- BLM BIA approvals/consents

- **Offshore**

- Interconnect design
- Maritime laws
- Unique construction facts

Federal Permitting Framework

- **Federal Land Policy and Management Act (FLPMA)**

- Title V governs grants of right-of-way “over, upon, under and through” the federal public lands

- **Solar & Wind Plans, Policies and Guidance**

- BLM Resource Management Plans (RMPs)
- Solar and Wind Programmatic Plans and Regulations
 - Wind Program/PEIS (2005)
 - Western Solar Program/PEIS (2012)
 - Solar and Wind Energy Rule (2017)

- **Regional Planning Processes**

- Desert Renewable Energy Conservation Plan (CA)
- Solar Energy Zones (e.g., Dry Lake SEZ)

BLM Development Process and Timing

- **ROW Application & Plan of Development (POD)**
- **Coordinated Reviews/Consultation**
 - National Environmental Policy Act (NEPA) review
 - EIS, EA/FONSI, Tiering to PEIS documents
 - Public comment process
 - Endangered Species Act (ESA) Section 7 consultation
 - National Historic Preservation Act (NHPA) Section 106 and tribal government-to-government consultation (EO 13175)
 - Cooperating federal agencies and joint state/local agency review
- **BLM Decision (ROD or Decision Record)**
- **ROW Grant Issuance & NTP**
- **Protest, administrative appeal and litigation**
- **Time considerations**

BIA Tribal Development Process

- **Tribal Contractual Rights**

- Tribal ground lease and related rights (e.g., road/transmission rights of way, materials supply agreements)
- Compliance with tribal development and environmental regulations
- Tribal Energy Resource Agreements

- **Bureau of Indian Affairs trustee review and approval**

- Focus on tribal self-determination and economic development opportunities
- Review of TERA compliance with federal law, public notice/comment, performance and reporting
- Exceptions for short-term leases and approved tribal leasing programs
- NEPA, ESA and NHPA compliance

- **Unique considerations on tribal lands**

- Sovereign immunity
- Taxation and regulatory authority

Complexities Unique to Federal Land Projects

- **ROW application priority**
- **Competitive leasing**
- **Land rent and MW capacity fee fluctuation**
 - Standard vs. scheduled rate increases
 - Pending IBLA challenges to rates
- **Non-exclusive nature of ROW interest**
- **Matching ROW structure/timing with PPAs and financing**
 - Partial assignments and common/shared facilities
- **New technologies (e.g., battery and other storage tech)**
- **Political priorities for development and staffing**

Pitfalls to Avoid and Market Trends

- Don't assume *any* physical work satisfies the test, stick with the enumerated examples in the IRS Notices for wind and solar
- Proper documentation and corroborative support is critical to show investors construction began in the applicable year
- Confirm no work started too early...could impact the date the project must achieve COD under the 4 year continuity safe harbor
- 2020 vs. 2019 Beginning of Construction – 60% PTC (or 18% ITC) vs. 40% PTC (or 12% ITC)
- Continuity Safe Harbor – Avoid facts and circumstances test
 - 5 year safe harbor for 2016 and 2017 projects. 4 year safe harbor for all other years. 10 year safe harbor for federal lands and offshore projects
 - Documentation of early continuous efforts to satisfy facts and circumstances tests
- Repower transactions
- Storage technology- growing trend
- Pay attention to permitting timelines
- Post-election extenders bill? Battery storage and/or offshore PTC bills? Stay tuned...