



The Wind Production Tax Credit: How to Interpret “Beginning Construction” in the American Taxpayer Relief Act of 2012

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Background

As part of the American Taxpayer Relief Act of 2012, Congress extended the wind Production Tax Credit (PTC) for a year and expanded the requirements for eligible projects.¹ For the past 20 years, to receive the PTC a project had to be placed “in service” for the end of the year. The new language, however, allows any wind facility to receive the credit if “the construction of which begins before January 1, 2014.”² Various parties are now arguing over the interpretation of that phrase. Some contend that construction “begins” when the physical activities of construction begin; others hold that construction begins when the company in question has invested a fixed percentage of the total cost of the project.³

If construction “begins” with five percent of project cost investment, many companies might make that token investment and then wait several years for technology to mature before commencing actual building activities. Companies that would otherwise expeditiously finish construction might stall at five percent investment while waiting for the economy to improve. Such an outcome would obviously be distortionary and economically harmful. Projects without full planning or financing by January 1, 2014 might nevertheless reap the tax credit years after meeting the five percent requirement.

If instead construction “begins” with the physical act of construction, companies that otherwise might have sat on their investments will be incentivized to commence building sooner. Earlier construction would mean that the economic benefits of construction would be realized more quickly. While more money might be paid out under the five percent interpretation, more short-term economic stimulus—the stated goal of those supporting the extension of the PTC—would come from the physical act requirement. Determining the meaning of construction “begin[ning]” is thus of critical importance for achieving the ends of the American Taxpayer Relief Act.

While it is not yet clear which government entity will issue guidance on this question—as past interpretations have been made by both the Joint Committee on Taxation and the Internal Revenue Service—the guidance should be based on a reasonable look at the history of similar

¹ Pub. L. No. 112-240, § 407(b), 126 Stat. 2313.

² *Id.*

³ Andrew Restuccia, *Wind industry awaits tax guidance on PTC rule* (Jan. 11, 2013), <http://www.politico.com/story/2013/01/wind-industry-awaits-tax-guidance-on-ptc-rule-86037.html>.

provisions. To that end, we have compiled a guide to how various courts and Congresses have recently decided what is required to begin construction.

Analysis

Tax Reform Act of 1969

The language of the Tax Reform Act of 1969 (“TRA 1969”) specified that one of its investment tax credits did not include property “the physical construction, reconstruction, or erection of which is begun after April 18, 1969[.]”⁴ The addition of the qualifier “physical” makes this example not precisely precedential since that qualifier is not present in the American Taxpayer Relief Act provision in question. However, the House Report on TRA 1969 sheds light on how strictly Congress intended such requirements to be interpreted:

The construction of property is to be considered as begun when work of a significant nature has begun with respect to the property. . . . However, construction of a facility will not be considered as begun if work has begun only on minor parts or components of it.⁵

The fact that “physical” was taken to mean something even beyond the mere commencement of physical building activity suggests that Congress’s use of the term “physical” did not seriously alter the meaning of “construction . . . which is begun”. This interpretation is borne out by Revenue Act of 1971 and its interpretation by the Treasury Department.

Revenue Act of 1971

With the Revenue Act of 1971, Congress restored the investment tax credit that had been taken out under the Tax Reform Act of 1969.⁶ However, Congress changed the statutory language in a very significant way, removing the qualification “physical”. The termination of the credit would not apply to property “the construction . . . which . . . is begun by the taxpayer after March 31, 1971.”⁷

The absence of the qualifier “physical” was not interpreted to signal a significantly looser interpretation of “construction beginning”. Rather, the Treasury Department declared that the provision meant “construction, reconstruction, or erection by the taxpayer begins when **physical work is started**[.]”⁸

⁴ Pub. L. No. 91-172, § 703(a), 661.

⁵ HR Rep 91-413, 1834.

⁶ Pub. L. No. 92-178, 85 Stat. 498.

⁷ Pub. L. No. 92-178, § 50, 85 Stat. 498.

⁸ Treas. Reg. 1.48-2(b)(5) (1985) (emphasis added).

The Treasury Department's interpretation of the Revenue Act of 1971 thus provides a clear rule: construction begins with physical work. That rule was echoed in several future laws.

Tax Reduction Act of 1975, Tax Reform Act of 1976, Revenue Act of 1978

In defining the construction period in reference to the Tax Reduction Act of 1975 (which reads "construction began"),⁹ the Tax Reform Act of 1976 (which reads "construction of the building or other improvement begins")¹⁰, and the Revenue Act of 1978 (which reads "contributions made [in aid of construction]"),¹¹ the IRS consistently applied the same interpretation, reflected in 26 CFR § 1.46-5(e): "The [construction] period begins on the date physical work on construction of the property commences."¹²

Tax Reform Act of 1986

The House Conference report for the Tax Reform Act of 1986 continued to use this interpretation, noting "construction of property is considered to begin when physical work of a significant nature starts."¹³

American Jobs Creation Act of 2004

The same basic interpretation carried on to the American Jobs Creation Act of 2004, when the House Conference Report on the bill interpreted a ship's "construction commencement date" to refer to "the date on which the physical fabrication of any section or component of the ship or submarine begins."¹⁴

IRS Interpretations of Tax Provisions Over the Past Decade

The Internal Revenue Service, on August 23, 2011, issued regulations pertaining to the expensing of refinery property. The regulation states that a provision relating to self-constructed property applies to property the taxpayer "begins [] constructing" before January 1, 2010.¹⁵ The regulation then stated:

[C]onstruction of property **generally begins when physical work of a significant nature begins**. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching.¹⁶

⁹ Pub. L. No. 94-12, § 44(e)(1)(A), 89 Stat. 26.

¹⁰ Pub. L. No. 94-455, § 189, 90 Stat. 1520.

¹¹ Pub. L. No. 95-600, § 362, 92 Stat. 2763.

¹² 26 CFR § 1.46-5 (2012).

¹³ H. Rep't No. 99-841, 99th Cong., 2d Sess., II-56 (1986).

¹⁴ H.R. Conf. Rep. 108-755, Section 708(c)(3).

¹⁵ 76 Fed. Reg. 52556-01, 52558 (proposed Aug. 23, 2011) (to be codified at 26 C.F.R. pt. 602).

¹⁶ *Id.* (emphasis added).

That language almost exactly matches the interpretation found in the House Report on TRA 1969, when the phrase being interpreted was “physical construction . . . has begun”. The IRS had come across the beginning construction issue before, ruling precisely the same way in 2008 about refineries¹⁷ and in 2006 about aircraft.¹⁸

The Five Percent Alternative

The IRS has, on occasion, provided a safe-harbor provision, allowing companies that have not begun physical construction to reap the benefit of a tax provision if they have paid more than a certain percentage of the project’s total cost.¹⁹ In interpreting Section 1603 of the American Recovery and Reinvestment Act of 2009, the Treasury Department interpreted “construction . . . began” as including a safe-harbor provision whereby paying five percent of a project’s total cost could constitute the beginning of construction.²⁰ The five percent rule is actually more lenient than most comparable safe-harbor provisions for beginning constructions, most notably pertaining to depreciation deductions.²¹

While some precedent does therefore exist for the five percent alternative, the weight of precedent rests firmly on the physical commencement of building interpretation.

Conclusion

In examples strewn across forty years, beginning construction has been interpreted in the same way: commencing the physical building process. That interpretation comports with a conventional understanding of beginning construction and, as the history reveals, both legislative and regulatory sources have almost always hewed close to that understanding.

¹⁷ 73 Fed. Reg. 39227-01, 39229 (proposed Jul. 9, 2008) (to be codified at 26 C.F.R. pt. 602).

¹⁸ 71 Fed. Reg. 51727-02, 51730 (proposed Aug. 31, 2006) (to be codified at 26 C.F.R. pt. 1).

¹⁹ See, e.g., Treas. Reg. 1.168(k)-1(b)(4)(iii)(B)(2) (pertaining to depreciation deductions).

²⁰ U.S. Dep’t of the Treas., Payments for Specified Energy Property in Lieu of Tax Credits under the American Recovery and Reinvestment Act of 2009, (2011), *available at* <http://www.treasury.gov/initiatives/recovery/Documents/GUIDANCE.pdf>.

²¹ See, e.g., Treas. Reg. 1.168(k)-1(b)(4)(iii)(B)(2).