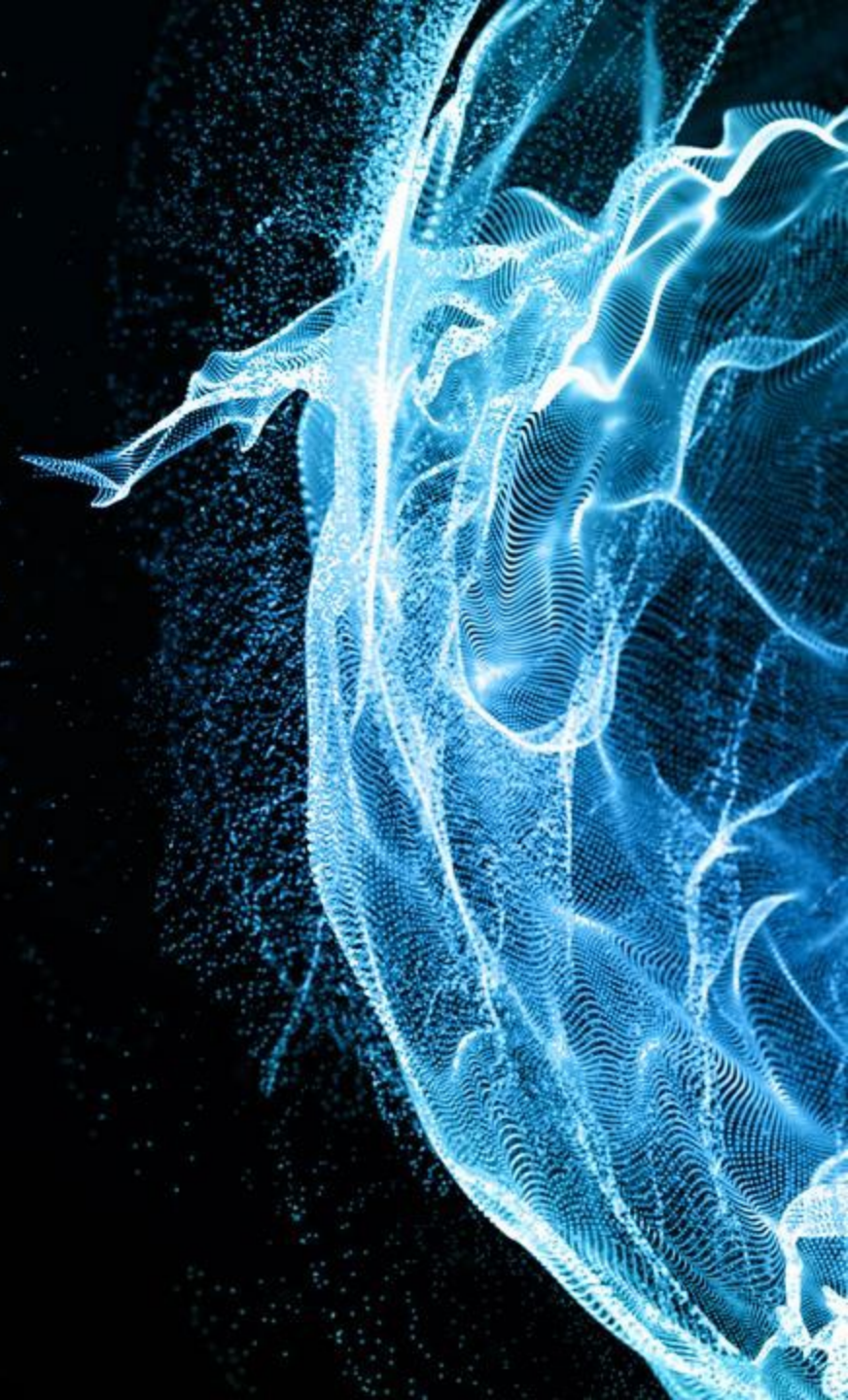


IRA direct pay compliance

December 12, 2025

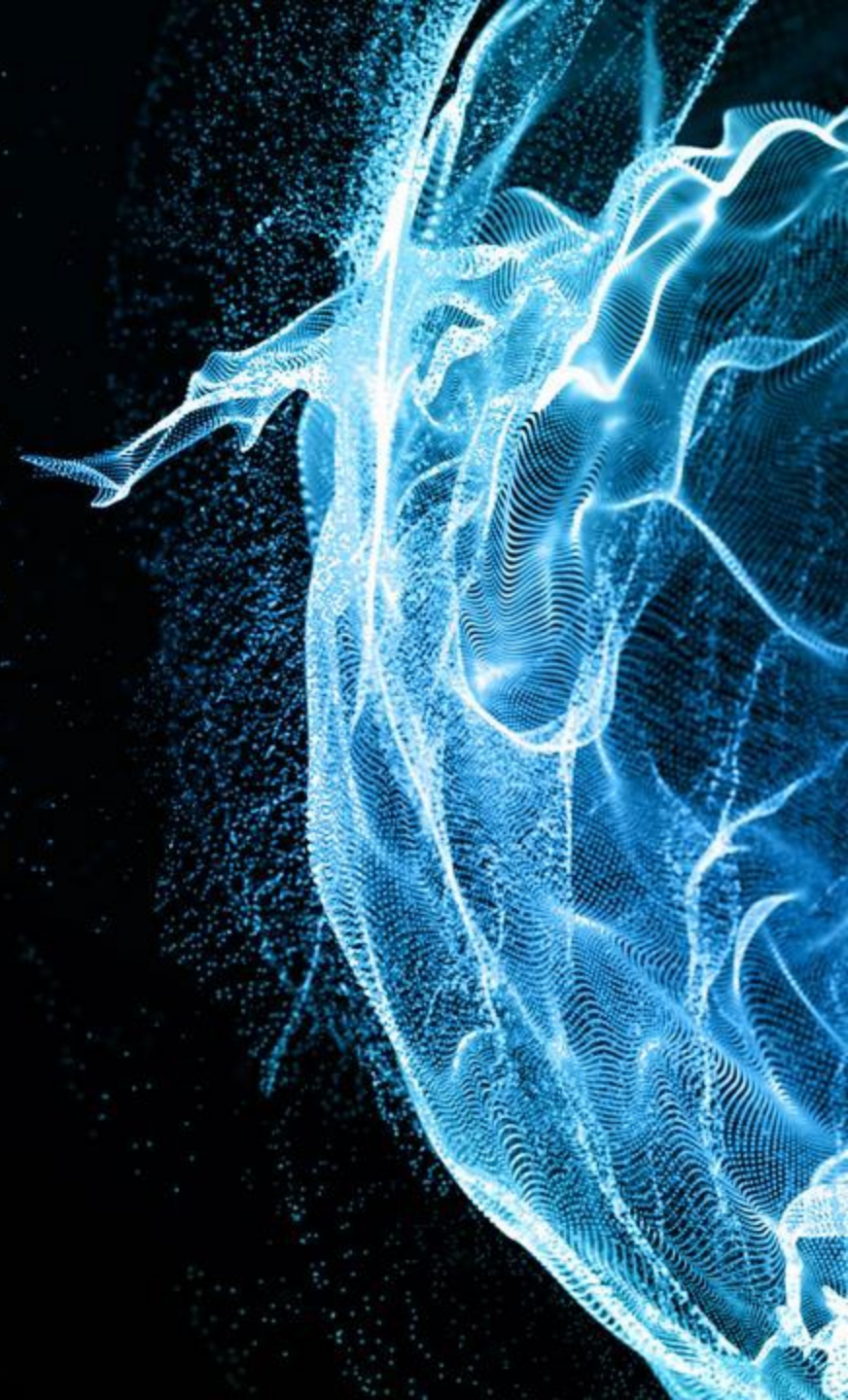
**Beginning of Construction (BOC)**





# Beginning of Construction Rules

## Prong 1: Beginning of Construction



# Beginning of Construction

## Overview – Prong 1

### Prong 1 – Begun Construction Requirement

The IRS provides two methods for taxpayers to establish the beginning of construction to claim the section 45 PTC or section 48 ITC.

- 1. 5% Safe Harbor** – Having paid or incurred at least five percent of the total cost of the depreciable basis of the facility or energy property, excluding land and property not integral to the facility. Integral part means all property used directly in the production of electricity from the renewable resource (a qualifying activity) and all property necessary for the completeness of the activity.
- 2. Physical Work Test** – Starting physical work of a significant nature (“PWSN”) onsite or offsite related to a qualified facility or energy property. Work may be performed by a third party on behalf of a taxpayer (i.e., through a vendor). The test focuses on the nature of work performed, not the amount or the cost paid or incurred. PWSN does not include preliminary activities, such as designing, research, environmental studies, or removal of existing foundations (“Preliminary Activities Exclusion”) or work to produce property that is existing inventory or is normally held in inventory by a vendor (“Inventory Exclusion”).

# Begun Construction Requirement

## 5% Safe Harbor

Construction of a facility or energy property will be considered as having begun before December 31, 2025, if (1) a taxpayer pays or incurs (within the meaning of Treas. Reg. § 1.461-1(a)(1) and (2)) five percent or more of the total cost of the facility or energy property, except as provided in section 5.01(2), before December 31, 2025 [or other applicable begun construction date], and (2) thereafter, the taxpayer makes continuous efforts to advance towards completion of the facility or energy property (as determined under section 5.02)

- **“Incurring” costs vs. making payment**

- Economic performance through delivery or transfer of tax ownership

- **3.5-month rule exception**

- Property or services reasonably expected to be provided within 3 ½ months of payment

- Method of accounting

- **Look-through Rule** for work performed under a binding written contract:

- “for property that is manufactured, constructed, or produced for the taxpayer by another person under a binding written contract with the taxpayer, costs incurred with respect to the property by the other person before the property is provided to the taxpayer are deemed incurred by the taxpayer when the costs are incurred by the other person under the principles of section 461”

If there is cost overrun on a single energy property, then the taxpayer cannot scale back to satisfy the 5% Safe Harbor



# Begun Construction

## 5% Safe Harbor – Look-through Rule and Percentage of Completion ("PCM") Requirement

**Look-through Rule** – A taxpayer effectively steps into the shoes of the vendor for purposes of demonstrating when costs are considered incurred

### Vendor costs are considered incurred:

1. When the vendor incurs internal costs, or
2. If the vendor contracts with a third party to provide property or services and –
  - a. The subcontractor provides the property or services,
  - b. The vendor pays the subcontractor for the property or services if the subcontractor provides the property or services within 3½ months of the date of payment, or
  - c. The earlier of when the subcontractor provides the property or service or the vendor pays the subcontractor for the property or services if the vendor's contract with the taxpayer is a long-term manufacturing or construction contract for tax purposes

### A cost is generally incurred pursuant to a Binding Written Contract for tax purposes when:

1. The fact of the liability is fixed;
2. The amount of the liability is determinable with reasonable accuracy; and
3. The economic performance test has been met with respect to such cost, meaning that the equipment has been delivered or ownership of the equipment has passed to the purchaser

**Percentage of Completion ("PCM")** – an accrual method taxpayer may be required to use PCM if it enters into a long-term contract where the completion of production is more than 12 months from the contract date. Costs are considered incurred under PCM at the earlier of payment (assuming the payment is due under the terms of the contract), or when tax ownership of the property is transferred.

# Begun Construction Requirement

## Physical Work Test – Facility and Energy Property Defined

A facility or energy property generally include all components of property that function interdependently:

Components of property are functionally interdependent if the placing in service of each of the components is dependent upon the placing in service of each of the other components in order to generate electricity

- Example: On a wind farm, an electricity-generating wind turbine, its tower and supporting pad comprise a single facility

For purposes of determining whether construction of a facility or energy property has begun, multiple facilities that are operated as part of a single project (or energy properties that are operated as a single energy property) will be treated as a single facility

Example factors indicating that multiple facilities (or energy properties) are operated as a single project include:

Single Project Factors	
• The facilities are owned by a single legal entity;	• The facilities share a common substation;
• The facilities are constructed on contiguous pieces of land;	• The facilities are described in one or more common environmental or other regulatory permits;
• The facilities are described in a common power purchase agreement or agreements;	• The facilities were constructed pursuant to a single master construction contract; and
• The facilities have a common intertie;	• The construction of the facilities was financed pursuant to the same loan agreement

# Begun Construction Requirement

## Physical Work Test – On-Site Examples



A taxpayer may demonstrate PWSN with both on-site and off-site work (performed either by the taxpayer or by another person under a binding written contract)

### On-Site Examples

<b>Wind Facilities</b>	<ul style="list-style-type: none"><li>Excavation for the foundation; setting of anchor bolts into the ground; or pouring of concrete pads for the foundation.</li><li>Roads that are integral to the facility (roads for equipment to operate and maintain the qualified facility), custom machinery or equipment, or Structure that houses property integral to the activity of the facility.</li></ul>	<b>Fiber-Optic Solar Energy Property</b>	<ul style="list-style-type: none"><li>Installation of collectors, concentrators, tracking systems, bundles of optical fibers, or fixtures within a structure.</li></ul>
<b>Hydropower Facilities</b>	<ul style="list-style-type: none"><li>Excavation for or construction of a penstock, power house, or retaining wall structure.</li></ul>	<b>Qualified Fuel Cell Property</b>	<ul style="list-style-type: none"><li>Installation of components of a fuel cell stack assembly, such as electrodes, gas diffusion layers, membranes, gasketing or plates.</li></ul>
<b>Biomass and Trash Facilities</b>	<ul style="list-style-type: none"><li>Site improvements (as opposed to site clearing), such as filling or compacting soil, or installing stack piling.</li></ul>	<b>Qualified Microturbine Property</b>	<ul style="list-style-type: none"><li>Installation of a gas turbine engine, combustor, recuperator, regenerator, generator, alternator, or other plant components.</li></ul>
<b>Geothermal Facilities</b>	<ul style="list-style-type: none"><li>Physical activities undertaken at a project site after a valid discovery, such as the installation of piping, turbines, generators, flash tanks, or heat exchangers.</li></ul>	<b>CHP</b>	<ul style="list-style-type: none"><li>Installation of a heat engine, generator, heat recovery components, or electrical interconnections.</li></ul>
<b>Solar</b>	<ul style="list-style-type: none"><li>Installation of racks or other structures to affix photovoltaic panels, collectors or solar cells to site.</li></ul>	<b>Qualified Small Wind Property</b>	<ul style="list-style-type: none"><li>Installation of a foundation, tower, wiring or grounding systems.</li></ul>
		<b>Geothermal Heat Pump Property</b>	<ul style="list-style-type: none"><li>Installation of ground heat exchangers, heat pump units or air delivery systems (ductwork).</li></ul>



# Begun Construction Requirement

## Physical Work Test – Off-Site Examples

### Examples from IRS Notices:

<b>Wind Facilities</b>	<ul style="list-style-type: none"><li>Physical work on a custom-designed transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission is PWSN with respect to the facility because power conditioning equipment is an integral part of the activity performed by the facility.</li><li>Regarding construction of step-up transformers and other major components. The IRS has said specifically: “If the facility’s wind turbines and tower units are to be assembled on-site from components manufactured off-site by a person other than the taxpayer and delivered to the site, PWSN begins when the manufacture of the components begins at the off-site location, but only if (i) the manufacturer’s work is done pursuant to a binding written contract and (ii) these components are not held in the manufacturer’s inventory.</li></ul>
<b>Solar</b>	<ul style="list-style-type: none"><li>Manufacture of components, mounting equipment, support structures, such as racks and rails, inverters, and transformers and other power conditioning equipment.</li></ul>

### Other Industry Examples:

- Nacelles;
- Inverters;
- Switchgear;
- Digester tanks from waste to energy facilities; and
- Foundations support structures.

# Begun Construction Requirement

## Physical Work Test – Binding Written Contract

- ☰ Binding Written Contract: Any work performed by a contractor is taken into account for PWSN only if it was done under a binding written contract with the taxpayer and the contract was in place before the work began.

A contract is binding only if:

1. The agreement must be enforceable under local law;
2. The agreement must not limit damages to less than 5% of the total contract price;
3. The agreement must not be an “option” and will require forfeiture of more than a “nominal” amount (e.g., 5 percent of the contract price); and
4. The agreement must not have a substantial modification.

- ☰ Other industry considerations:

1. No clause allowing termination for convenience;
2. No suspensions; and
3. No returns or exchanges.

A taxpayer may demonstrate PWSN with both on-site and off-site work (performed either by the taxpayer or by another person under a binding written contract)

# Begun Construction Requirement

## Physical Work Test – Exclusions

**Preliminary Activities Exclusion:** Even if the cost of the preliminary activities is properly included in the depreciable basis of the facility, preliminary activities do not count towards PWSN

### Preliminary Activities Examples

- Planning and designing;
- Conducting environmental and engineering studies;
- Securing financing;
- Performing activities to develop a geothermal deposit prior to valid discovery;
- Exploring;
- Clearing a site;
- Researching;
- Conducting test drilling to determine soil condition;
- Conducting geological mapping and modeling;
- Excavating to change the contour of the land;
- Obtaining permits and licenses;
- Removing existing turbines and towers, solar panels, or any components that will no longer be part of the facility; and
- Conducting geophysical, gravity, magnetic, seismic and resistivity surveys

### Inventory Exclusion:

PWSN does not include work to produce property that is in existing inventory or is normally held in inventory by a vendor

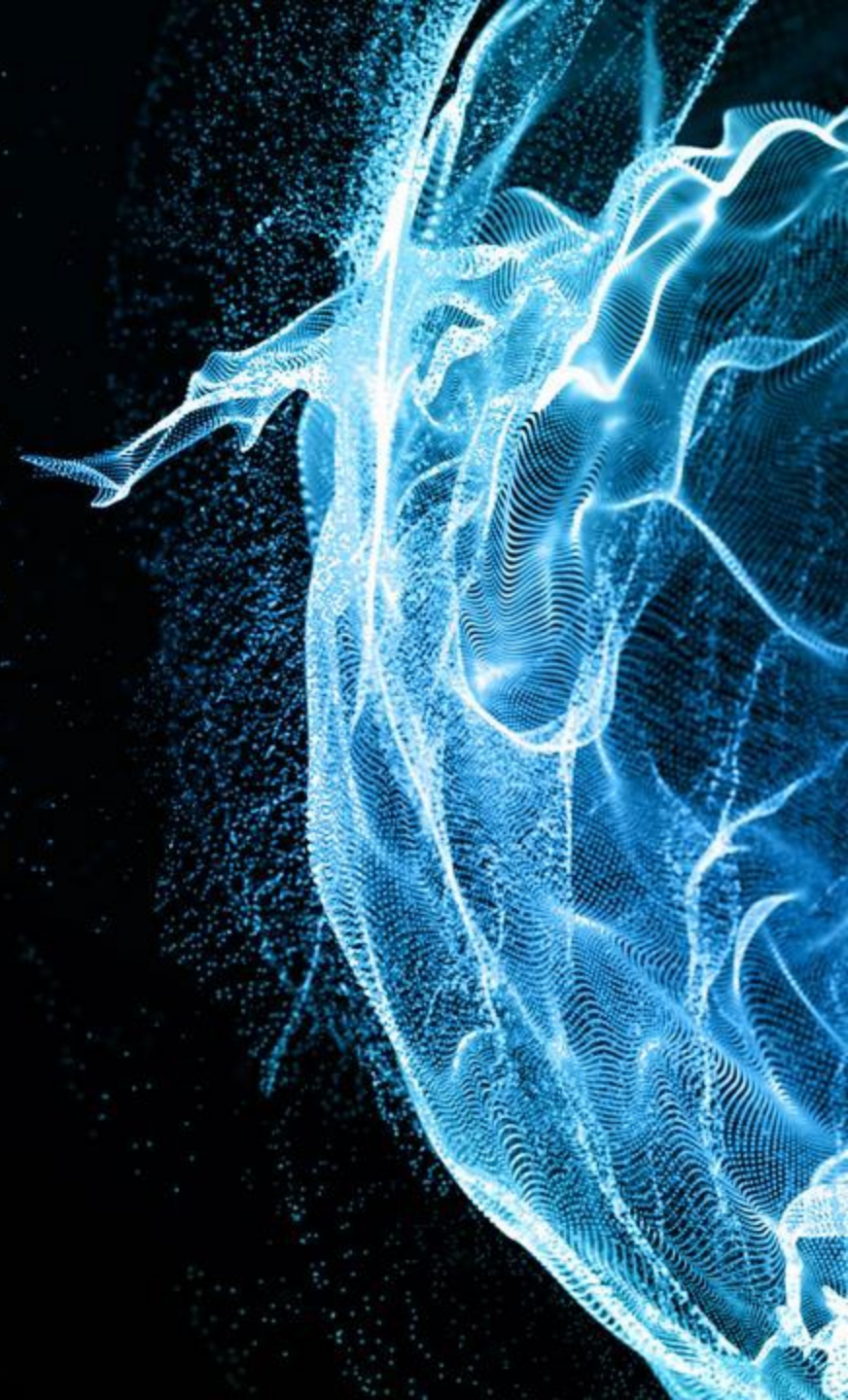
### Other Excluded Activities:

- Roads primarily for access to the site, or roads used primarily for employee or visitor vehicles are not integral to the activity performed by the facility;
- Fencing; and
- Buildings not integral to the activity of the facility



# Beginning of Construction Rules

## Prong 2: Continuity Requirement



# Beginning of Construction

## Overview – Prong 2

### Prong 2 – Continuity Requirement

Both methods require that the taxpayer makes continuous progress toward completion (from the time the construction has begun until the facility is placed in service) based on relevant facts and circumstances (“Continuity Requirement”).

- 1. Continuous Efforts Test (for 5% Safe Harbor or Physical Work Test)** – A taxpayer must maintain continuous efforts to advance towards completion through the placed in service date: (a) paying or incurring additional amounts included in the total cost of the facility; (b) entering into binding written contracts for components or future work on construction of the facility; (c) obtaining necessary permits; and (d) performing PWSN.
- 2. Continuous Construction Test (for 5% Safe Harbor or Physical Work Test)** – A taxpayer must maintain a continuous program of construction through the placed in service date. A continuous program of construction involves continuing PWSN, such as off-site manufacturing of components, mounting equipment, support structures, inverters, transformers, and other power conditioning equipment, as well as certain on-site work.
- 3. Continuity Safe Harbor** – Continuous Construction and Continuous Efforts are deemed satisfied if the facility or energy property is placed in service within 4, 5, 6 or 10 calendar years of the year in which construction began (“Continuity Safe Harbor”) depending on the technology and year in which construction began.

**Notice 2021-41** issued on June 29, 2021 modified Notice 2020-41 and extended the Continuity Safe Harbor period to **6 years** for projects that began construction in calendar year 2016, 2017, 2018 or 2019, and to **5 years** for projects that began construction in calendar year 2020. Additionally, Notice 2021-41 permits all ITC and PTC projects to apply the Continuous Efforts Test (rather than the more stringent Continuous Construction Test) in order to satisfy the Continuity Requirement. **Notice 2021-05** issued on December 31, 2020 extends the Continuity Safe Harbor period from four years to **10 years** for a qualified facility or energy property constructed on Federal lands and all offshore wind projects.

# Beginning of Construction

## Continuity Requirement: Excusable Disruptions

IRS Notices provide that certain disruptions in a taxpayer's continuous construction or continuous efforts to advance towards completion of an energy property that are beyond the taxpayer's control will not be considered as indicating that a taxpayer has failed to satisfy the Continuity Requirement. However, these disruptions will not extend the Continuity Safe Harbor Deadline:

- Labor stoppages;
- Natural disasters;
- Inability to obtain specialized equipment of limited availability;
- The presence of endangered species;
- Financing delays;
- Delays in the manufacture of custom components;
- Supply shortages;
- Severe weather conditions;
- Delays in obtaining permits or licenses (Specifically, from federal, state, local or Indian tribal governments, including, but not limited to delays in obtaining permits or licenses from the Federal Energy Regulatory Commission, the Environmental Protection Agency, the Bureau of Land Management and the Federal Aviation Agency);
- Delays at the written request of a federal, state, local or Indian tribal government regarding matters of public safety, security or similar concerns; and
- Interconnection-related delays, such as those relating to the completion of construction on a new transmission line or necessary transmission upgrades to resolve grid congestion issues that may be associated with a project's planned interconnection





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