Alert | Energy Project Finance & Development

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IRS Issues Guidance for Developers, Investors Seeking to Qualify for Energy Community Bonus Credits Under Inflation Reduction Act

On April 4, the Internal Revenue Service issued Notice 2023-29 (the Notice), which describes certain rules the IRS intends to include in proposed regulations for qualifying for the energy community bonus production tax credit (PTC) rate and investment tax credit (ITC) amount under the Inflation Reduction Act of 2022 (IRA).

Internal Revenue Code (the Code) Sections 45(b)(11) and 48(a)(14) outline the energy community bonus credit requirements that taxpayers must satisfy to qualify as an energy community project (EC Project) and claim the increased credit amounts or rates. Similar requirements are in place for an energy community adder under the new clean electricity production tax credit and clean electricity investment tax credit under Code Sections 45Y(g)(7) and 48E(a)(3)(A), respectively, for certain qualified facilities, energy projects, and energy storage technologies that are placed in service after Dec. 31, 2024.

There are three location-based categories of energy communities:

1. Brownfield: The Brownfield category includes real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant and certain mine-scarred land.

2. Statistical Area: The Statistical Areas category includes metropolitan statistical areas (MSAs) and non-MSAs that (i) have (or had at any time after Dec. 31, 2009) 0.17% or greater direct employment (Fossil Fuel Employment) or 25% or greater local tax revenues (Fossil Fuel Tax Revenue) related to the extraction, processing, transport, or storage of coal, oil, or natural gas; and (ii) have an unemployment rate at or above the national average unemployment rate for the previous year.

3. Coal Closure: The Coal Closure category includes census tracts in which (i) a coal mine has closed after Dec. 31, 1999; or (ii) a coal-fired electric generating unit has been retired after Dec. 31, 2009. Census tracts that are directly adjoining at any single point to these census tracts are also included in the Coal Closure category.

To qualify for the energy community bonus credit, the Notice makes the distinction that qualified facilities claiming the PTC must be "located in" an energy community, which is determined separately for each year of the 10-year PTC period, and, for ITC purposes, an energy project, qualified facility, or energy storage technology must be "placed in service" within an energy community.

A taxpayer-friendly rule allows taxpayers to begin construction after Dec. 31, 2022, on an EC Project in a location that is an energy community when construction begins and permits the project to continue to be considered an energy community for the 10-year credit period following the date a project is placed in service (for PTC) or placed in service date (for ITC).

For projects that are partially located in an energy community, the Notice provides two tests to determine how much of an EC Project must be located in or placed in service within an energy community in order to qualify for the energy community adder. EC Projects must satisfy the Nameplate Capacity Test (if the project has a nameplate capacity) or the Footprint Test (if the project does not have a nameplate capacity (e.g., qualified biogas property)). Under the Nameplate Capacity Test, the project must have at least 50% of the project's nameplate capacity in an area that qualifies as an energy community. Under the Footprint Test, the project must have at least 50% of the project's square footage in an area that qualifies as an energy community.

Taxpayers must meet the general recordkeeping requirements to substantiate that an EC Project qualifies for the energy community bonus credit adder. The recordkeeping requirements include keeping permanent books of account or records that are sufficient to establish the amount of gross income, deductions, credits, and other matters required in any tax return.

The IRS intends to propose that the regulations will apply to taxable years ending after April 4, 2023, but until the issuance of the forthcoming proposed regulations, taxpayers may rely on the rules described in the Notice.

GT Insights

Previous Construction: Taxpayers that established the beginning of construction before release of the Notice may benefit from confirmation that these projects will continue to qualify for the energy community bonus credit adder either: (i) when the taxpayer first established the beginning of construction; or (ii) the year in which the taxpayer continues construction after the date of the Notice.

Beginning Construction on EC Projects in 2023 and Later: As discussed above, a project continues to be considered an EC Project for the duration of the 10-year credit period for PTC purposes if construction began Jan. 1, 2023, or later (rather than separately evaluating qualification for each year during the 10-

year credit period). Taxpayers can benefit from modeling the production and credit amount while having comfort that a PTC project qualifying for the energy community bonus credit adder will maintain the EC Project status for the entire credit period.

Continuity Safe Harbor: Previous guidance established a continuity safe harbor that would allow projects to begin construction and be deemed to satisfy continuity requirements if the project is placed in service within a specific number of years after establishing the beginning of construction. Additional guidance would be helpful to confirm whether the same continuity safe harbor applies to projects establishing beginning of construction for purposes of the energy community adder.

Assigning to Specific Project Sites: The Notice does not provide clarity surrounding the timing of when a project establishes the beginning of construction and whether the project has been properly associated to a project site location. Currently, projects establish the beginning of construction based on the Physical Work Test or 5% Safe Harbor. However, there has been little guidance as to when off-site physical work (for the Physical Work Test) or components that were paid or incurred (under the 5% Safe Harbor) must be assigned to a specific project site, which may now be located in an energy community for the bonus credit adder.

Census Tracts: For purposes of determining whether a census tract is an energy community, the term "census tract" is defined and delineated by the Census Bureau for purposes of the 2020 Decennial Census (as described in 83 FR 56277). There is potential for census tracts to change over time, and it is unclear whether the IRS intends to use the 2020 data for the future.

Brownfield Sites: Other than for mine-scarred land, the Notice provides a safe harbor for taxpayers who can qualify an EC Project located on a site meeting the "brownfield site" definition under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 through: (i) a Phase I Environmental Site Assessment on projects with a nameplate capacity of not greater than 5 MWac; (ii) a Phase II Environmental Site Assessment confirming the presence on the site of a hazardous substance, a pollutant or contaminant; or (iii) a previous assessment from the federal, state, territory, or federally recognized Indian tribal resources that determined the project site meets the definition of a brownfield site. The government has not provided a mapping tool to locate eligible brownfield sites. Unlike the other categories, the IRS does not plan to provide updates to this category. As such, environmental counsel may be helpful for taxpayers trying to determine whether their project qualifies under the brownfield category. Moreover, these rules may present an interesting dichotomy because in absence of this energy community bonus credit category, it would have been generally unfavorable to find presence on the site of a hazardous substance, pollutant, or contaminant through an Environmental Site Assessment.

MSAs and Non-MSAs: The tables provided in Appendix B to the Notice (see below) includes MSAs and non-MSAs that meet the Fossil Fuel Employment threshold, but the unemployment rate requirement is yet to be determined. Because the Statistical Area category relies on fluctuating unemployment information, it will be important for taxpayers to rely on the rule that allows taxpayers to begin construction of an EC Project in a location that is an energy community at the time that construction begins.

Nameplate Capacity Test: There is uncertainty in relation to satisfying the Nameplate Capacity Test in years following an event that alters the nameplate capacity of the EC Project; most likely as a decrease following a casualty event. Does recapture take place or does the EC Project lose its qualification of an EC Project for future tax years?

Footprint Test: The Footprint Test does not explain what is included in square footage, such as roads and other areas located on the property but not used to produce electricity.

Fossil Fuel Tax Revenue Test: The Notice does not provide a methodology to calculate the Fossil Fuel Tax Revenue Test, but written comments addressing the possible data sources, revenue categories, and procedures to determine whether an MSA or non-MSA qualifies under the Statistical Area category based on Fossil Fuel Tax Revenue can be submitted by May 4, 2023.

Coal-Fired Electric Generating Units: A coal-fired electric generating unit may operate in a plant with multiple units. Retirement of any such unit at a plant would cause the census tract to be included in the Coal Closure category. Added clarity would be beneficial around whether a coal-fired electric generating unit that was later converted to another type of technology and retired would still qualify for the Coal Closure category if a different type of technology was used at the time of retirement.

Future Qualifications for PTC Projects: It appears that a PTC project in an area that didn't initially meet the energy community requirement as of the project's placed-in-service date may qualify as an EC Project in future years by, for example, being located in an area that becomes an energy community due to change in unemployment rates.

Inaccurate Qualifications: Other ITC and PTC IRA provisions provide for correcting or curing failures to satisfy requirements for increased tax credit rates or amounts. For example, taxpayers can cure a failure to satisfy wage requirements and pay a related penalty. A similar provision for the energy community adder would benefit taxpayers that incorrectly determined a project was located in an energy community.

Resources

Appendix A, released with the Notice, includes IRS-defined MSAs and non-MSAs for the Statistical Area category.

Appendix B, released with the Notice, includes MSAs and non-MSAs that meet the Fossil Fuel Employment threshold, but the unemployment rate requirement is yet to be determined (annual unemployment rates are typically released in April of the following year).

Appendix C, released with the Notice, includes census tracts and adjoining census tracts for the Coal Closure category.

The IRS and Treasury have collaborated with other governmental departments to identify potential energy communities. The Interagency Working Group on Coal and Power Plant Communities and Economic Revitalization released a mapping tool that reflects the locations that fall within the Statistical Area category and the Coal Closure category.

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