TREASURY AND IRS PROPOSE REGULATIONS FOR INFLATION REDUCTION ACT'S LOW-INCOME COMMUNITIES BONUS CREDIT PROGRAM

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US Energy, Infrastructure, and Resources Alert

By: Martha G. Pugh, Mary Burke Baker, David Wang

On 1 June 2023, the US Department of the Treasury (Treasury) and Internal Revenue Service (IRS) issued a notice of proposed rulemaking (NOPR) regarding the Low-Income Communities Bonus Credit Program (Program) established under Section 48(e) of the Internal Revenue Code (Code), pursuant to the Inflation Reduction Act of 2022 (IRA).[1] The Program provides for increases in the amount of energy investment credits available under Code Section 48(a) (Section 48(e) Increase) to certain applicants by allocating environmental justice solar and wind capacity limitation (Capacity Limitation) to qualified facilities.

The IRS previously released Notice 2023-17, which provided initial guidance for potential applicants seeking allocations of calendar year 2023 Capacity Limitation.

This NOPR generally adopts the guidance set forth in Notice 2023-17 but, critically, changed many important aspects, imposed additional qualification requirements, and clarified previously undefined terms. This alert provides an overview of this NOPR and specifically discusses the following:

- What solar and wind facilities qualify for the Section 48(e) Increase;
- The four categories of qualified facilities;
- The specific "financial benefits" (Financial Benefits) requirements for facilities otherwise eligible for a 20% Section 48(e) Increase;
- Ineligibility of facilities placed in service prior to Capacity Limitation allocation;
- Additional criteria that, if met, allow qualified facilities to get priority Capacity Limitation allocation; and
- Conditions that will lead to post-Capacity Limitation allocation disqualification from, and recapture of, the Section 48(e) Increase.

QUALIFIED FACILITY DEFINED

A qualified facility is defined as a solar or wind facility that:

1. Generates electricity solely from a wind facility, solar energy property, or small wind energy property;
2. Has a maximum net output of less than five megawatts (MW), as measured in alternating current; and
3. Falls under one of the four categories set in Code Section 48(e) (see below).

In the NOPR, Treasury and the IRS express concern that applicants will artificially divide larger projects into smaller projects that each have a maximum net output of less than five MW in order to qualify for the Section 48(e) Increase. Therefore, for the purposes of the Program, Treasury and the IRS will aggregate into a single facility separate solar or wind energy properties that are operated as part of a single project based on a set of factors outlined in earlier notices issued by the IRS related to the beginning-of-construction rules.[2] This is an area that many taxpayers are likely to be interested in because of the economies of scale that result from multiple projects being developed at the same time and located in the same geographical or electrical area.

FOUR CATEGORIES OF QUALIFIED FACILITIES

The specific allocation of a qualified facility's Capacity Limitation depends on where the qualified facility is located or whether it is part of a defined type of low-income project. These qualified facilities are separated into four categories. Category 1 and Category 2 facilities are eligible for a 10% Section 48(e) Increase. Category 3 and Category 4 facilities are eligible for a 20% Section 48(e) Increase.

A Category 1 or Category 2 facility that also qualifies as a Category 3 or Category 4 facility is considered a Category 3 or Category 4 facility (as applicable), and therefore is eligible for a 20% Section 48(e) Increase.

Category 1: Facilities Located in Low-Income Communities

A Category 1 facility is a facility located in a Low-Income Community, as defined by the Code Section 45D New Markets Tax Credit. Such communities include any population census tract that has:

- A poverty rate of 20% or greater;[3] or
- Either of the following:
    - A median family income that does not exceed 80% of the statewide median family income if the census tract is not located in a metropolitan area;[4] or
    - A median family income that does not exceed 80% of the greater of statewide median family income or the metropolitan area's median family income if the census tract is located in a metropolitan area.[5]

Treasury and the IRS propose to reserve 700 MW of Capacity Limitation for calendar year 2023 for Category 1 facilities. They also propose, however, to subdivide this Capacity Limitation further, with 560 MW reserved specifically for eligible residential behind-the-meter (BTM) facilities, and 140 MW reserved for front-of-the-meter facilities and other non-residential BTM facilities.

Category 2: Facilities Located on Indian Land

A Category 2 facility is a facility located on Indian Land, as defined in the Energy Policy Act of 1992.[6] This includes any land that is:

- Located within the boundaries of an American Indian reservation, pueblo, or rancheria;
- Held in trust by (or held by the United States for the benefit of) an American Indian tribe or individual, or a dependent American Indian community;
- Owned by an American Indian tribe and was conveyed to an Alaska Native Corporation (ANC) (or was conveyed to an ANC in exchange for such land);

- Located in a census tract in which the majority of residents are Alaska Natives; or
- Located in a census tract in which the majority of residents are enrolled members of a federally recognized tribe or village.

Treasury and the IRS propose to reserve 200 MW of Capacity Limitation for calendar year 2023 for Category 2 facilities.

Category 3: Facilities That Are Part of a Qualified Low-Income Residential Building Project

A Category 3 facility is a facility that is treated as part of a qualified low-income residential building project. A facility will be treated as such if: (1) it is installed on a residential rental building that participates in an affordable housing program, and (2) the Financial Benefits of the electricity produced by such facility are allocated equitably among the occupants of the dwelling units of such building. What constitutes Financial Benefits is discussed in the following section. A qualifying affordable housing program includes any of the following:

- A covered housing program, as defined in the Violence Against Women Act of 1994;[7]
- A housing assistance program administered by the Department of Agriculture under Title V of the Housing Act of 1949;[8]
- A housing program administered by a tribally designated housing entity (as defined in the Native American Housing Assistance and Self-Determination Act of 1996);[9] or
- Other affordable housing programs that are specially designated.

Treasury and the IRS propose to reserve 200 MW of Capacity Limitation for calendar year 2023 for Category 3 facilities.

Category 4: Facilities That Are Part of a Qualified Low-Income Economic Benefit Project

A Category 4 facility is a facility that is treated as part of a qualified low-income economic benefit project. A facility will be treated as part of a qualified low-income economic benefit project if at least 50% of the Financial Benefits of the electricity produced by such facility are provided to households with an income of:

- Less than 200% of the poverty line (as defined in 26 U.S. Code § 36B applicable to a family of the size involved); or
- Less than 80% of an area's median gross income (as determined under Code Section 142(d)(2)(B) applicable to qualified residential rental projects for purposes of the exempt facility bond program).

What constitutes Financial Benefits is discussed in the following section. Treasury and the IRS propose to reserve 700 MW of Capacity Limitation for calendar year 2023 for Category 4 facilities.

The below table summarizes the four categories of facilities.

Category	Description	Summary	Capacity Limitation	Sec. 48(e) Increase

Category	Description	Summary	Capacity Limitation	Sec. 48(e) Increase
Category 1	Located in a Low-Income Community	Facility located in a census tract where the: ▪ Poverty rate ≥2 0%; ▪ Median family income < 80% of state median family income (non-metro area); or ▪ Median family income < 80% of greater of state/metro median family income (metro area).	700 MW	10%
Category 2	Located on Indian Land	Facility located on Indian Land, as defined by Energy Policy Act of 1992.	200 MW	10%
Category 3	Qualified low-income residential building project	Facility: ▪ Installed on a residential rental building that participates in an affordable housing program; and ▪ Produces electricity, the financial benefits of which are allocated equitably among occupants of such building's dwelling units.	200 MW	20%
Category 4	Qualified low-income economic benefit project	▪ 140 MW reserved for front-of-the-meter facilities and other non-residential BTM facilities.< 200% of poverty line; or ▪ < 80% of area's median gross income.	700 MW	20%

FINANCIAL BENEFITS FOR CATEGORY 3 AND CATEGORY 4 ALLOCATIONS

As noted above, both Category 3 and Category 4 facilities require Financial Benefits to be distributed to certain beneficiaries in order for a facility to qualify for the Section 48(e) Increase. Pursuant to Code Section 48(e)(2)(D), these Financial Benefits include “electricity acquired at a below market rate”; however, the Code does not specifically define what this term means. The following subsections describe the specific requirements for these required Financial Benefits.

We note that failure to provide these Financial Benefits over the five-year period after the facility's original placed-in-service date will subject the applicant to recapture.

Category 3: Facilities That Are Part of a Qualified Low-Income Residential Building Project

For Category 3 facilities that are part of a qualified low-income residential building project, Treasury and the IRS recognize that not all the financial value of net energy savings can be passed on to a building's occupants because a certain percentage can be assumed to be dedicated to lowering the operational costs of energy consumption for common areas—a benefit that all building occupants enjoy. Therefore, in order to qualify as a Category 3 facility, Treasury and the IRS propose that at least 50% of the financial value of net energy savings must be equitably passed on to building occupants. How the "financial value of net energy savings" is determined depends on whether the facility and the building are owned by the same entity:

- If the facility and the building have the same ownership, the financial value of net energy savings is measured as the financial value equal to the greater of:
  - 25% of the gross financial value of the annual energy produced; or
  - The gross financial value of the annual energy produced minus the annual costs to operate the facility.[10]
- If the facility and the building have different ownership (i.e., the facility owner enters into a power purchase agreement with the building owner),[11] the financial value of net energy savings is measured as the financial value equal to the greater of:
  - 50% of the financial value of the annual energy produced by the facility, which accrues to the owner of the qualified residential property in the form of utility bill credits or cash payments for net excess generation; or
  - The financial value of the annual energy produced by the facility, which accrues to the owner of the qualified residential property in the form of utility bill credits or cash payments for net excess generation minus any payments made by the building owner to the facility owner for energy services associated with the facility in a given year.

Both of these calculations are subject to additional requirements, which are found in the proposed regulations.

Treasury and the IRS have also proposed regulations specific to sub- or master-metered buildings. For sub-metered buildings, Treasury and the IRS propose that tenants receive financial value associated with utility bill savings in the form of a credit on their utility bills. For master-metered buildings (whose residents do not receive utility bills based on individual metering), Treasury and the IRS propose that that building occupants provide other benefits to building residents beyond those provided prior to the qualifying facility being placed into service. Treasury and the IRS ultimately defer to existing and future US Department of Housing and Urban Development guidance on this issue.

Category 4: Facilities That Are Part of a Qualified Low-Income Economic Benefit Project

For Category 4 facilities that are part of a qualified low-income economic benefit project, Treasury and the IRS propose to require that the facility serves multiple households and at least 50% of the facility's total output is distributed to qualifying low-income households. Treasury and the IRS also propose to reserve allocations exclusively for applicants that would provide at least a 20% bill credit discount rate for all such low-income households. Verification of the households' qualifying low-income status would be required to receive this discount rate.

FACILITIES PLACED IN SERVICE PRIOR TO ALLOCATION INELIGIBLE

As Treasury and the IRS stated in Notice 2023-17, facilities placed in service[12] prior to being awarded an allocation of Capacity Limitation are not eligible to receive an allocation and therefore are not eligible for the Section 48(e) Increase.

PRIORITY GIVEN TO FACILITIES MEETING ADDITIONAL SELECTION CRITERIA

Treasury and the IRS have changed their allocation selection approach from what was proposed in Notice 2023-17. In this new approach, Treasury and the IRS will open an initial application window where all timely submitted applications will be considered together, followed by a rolling application process if Capacity Limitation is not fully allocated. Allocation priority will be given to facilities that meet at least one of two new proposed allocation criteria: (1) Ownership Criteria, and (2) Geographic Criteria:

Ownership Criteria

An otherwise qualified facility meets the Ownership Criteria if it is owned by:

- A tribal enterprise (i.e., a tribal-owned corporation);
- An ANC;
- A renewable energy cooperative;[13]
- A renewable energy company that serves low-income communities and provides pathways for the adoption of clean energy by low-income individuals; or
- A qualified tax-exempt entity, which includes state and local governments, tribes, and electricity cooperatives.

Geographic Criteria

An otherwise qualified facility meets the Geographic Criteria if it is located at the time of application in:

- A persistent poverty county, which is generally defined as a county where 20% or more of residents have experienced high rates of poverty over the past 30 years; or
- A census tract that is designated in the Climate and Economic Justice Screening Tool as disadvantaged based on whether the tract is either:
  - Greater than or equal to the 90th percentile for energy burden and is greater than or equal to the 65th percentile for low income; or
  - Greater than or equal to the 90th percentile for PM2.5 exposure and is greater than or equal to the 65th percentile for low income.

POST-ALLOCATION COMPLIANCE RULES: DISQUALIFICATION AND RECAPTURE

Under the NOPR, facilities that receive Capacity Limitation allocations must satisfy certain requirements prior to being placed in service. Treasury and the IRS propose that a facility that was awarded a Capacity Limitation allocation is disqualified from receiving that allocation if prior to or upon the facility being placed in service:

- The location where the facility will be placed in service changes;
- The nameplate capacity of the facility increases to be greater than 5 MW, thereby exceeding the limit set forth by Code Section 48(e)(2)(A)(ii)[14] or decreases by the greater of two kilowatts or 25% of the Capacity Limitation awarded in the allocation;
- The facility qualified as a Category 3 or Category 4 facility but cannot satisfy the Financial Benefits requirements applicable to those facilities;
- The eligible property that is part of the facility that received the Capacity Limitation allocation is not placed in service within four years after the date the applicant was notified of the allocation of Capacity Limitation to the facility; or
- Subject to exceptions, the facility received a Capacity Limitation allocation based, in part, on meeting the Ownership Criteria and ownership of the facility changes prior to the facility being placed in service.

As noted above, Category 3 and Category 4 facilities are subject to recapture risk if they fail to provide the required Financial Benefits to the designated recipients over the five-year period after the facility's original placed-in-service date. Additionally, all qualified facilities are subject to recapture risk if they increase net output to greater than five MW (unless the applicant proves that the output increase is not attributable to the original facility but instead is due to output associated with a new facility under the 80/20 rule, pursuant to IRS Revenue Rule 94-31).

REQUEST FOR COMMENTS

Treasury and the IRS request comments on all aspects of the NOPR, but have expressly solicited comments regarding the following:

- Proposed definitions and requirements, including whether these proposed definitions and requirements should apply for the Program in future years and a separate low-income communities program under the Code Section 48E clean energy Investment Tax Credit that will be established in 2024;
- For Category 3 facilities, how to adjust definitions of gross financial value to account for scenarios in which building occupants are compensating the facility owner for energy services;
- For Category 3 facilities, how Financial Benefits, such as services and building improvements, can be provided to residents in residential buildings located in states or municipalities where it may not be administratively or legally possible to apply utility bill savings on residents' electricity bills; and
- Proposed requirements to qualify as a qualified renewable energy company to satisfy the Ownership Criteria.

Comments must be received by 30 June 2023. Our lawyers in the Energy, Infrastructure, and Resources practice area are available to assist to help you further understand these proposed requirements and prepare comments to submit to Treasury and the IRS.

FOOTNOTES

[1] *See* Additional Guidance on Low-Income Communities Bonus Credit Program, 88 Fed. Reg. 35,781 (Jun. 1, 2023).

[2] *See* Section 7.01(2)(a), Notice 2018-59 (Beginning of Construction for the Investment Tax Credit under Section 48); Section 4.04(2), Notice 2013-29 (Beginning of Construction for Purposes of the Renewable Electricity Production Tax Credit and Energy Investment Tax Credit).

[3] Code Section 45D(e)(1)(A).

[4] Code Section 45D(e)(1)(B)(i).

[5] Code Section 45D(e)(1)(B)(ii).

[6] *See* 25 U.S.C. § 3501(2).

[7] *See* 34 U.S.C. § 12491(a)(3).

[8] *See* 42 U.S.C. § 1471 *et seq.*

[9] *See* 25 U.S.C. § 4103(22).

[10] Treasury and IRS propose to calculate “gross financial value” of the annual energy produced as the sum of (a) the total self-consumed kilowatt-hours produced by the qualified solar and wind facility multiplied by the applicable building's metered price of electricity, and (b) the total exported kilowatt-hours produced by the qualified solar and wind facility multiplied by the applicable building's volumetric export compensation rate for solar and wind kilowatt-hours. The annual operating costs are calculated as the sum of annual debt service, maintenance, replacement reserve, and other costs associated with maintaining and operating the qualified solar and wind facility.

[11] The NOPR does not specify whether common upstream ownership constitutes same or different ownership.

[12] The NOPR does not define what specifically constitutes “placed in service.”

[13] The NOPR defines an renewable energy cooperative as entity that develops qualified solar and/or wind facilities and owns at least 51 percent of a facility and is either (1) a consumer or purchasing cooperative controlled by its members who are low-income households (as defined in section 48(e)(2)(C)) with each member having an equal voting right, or (2) a worker cooperative controlled by its worker-members with each member having an equal voting right.

[14] We note that while the NOPR refers to the nameplate capacity of the facility in this section, the actual limit set forth by Code Section 48(e)(2)(A)(ii) is denominated as the net output of the facility.

KEY CONTACTS

MARTHA G. PUGH
PARTNER

WASHINGTON DC
+1.202.778.9033
MARTY.PUGH@KLGATES.COM

MARY BURKE BAKER
GOVERNMENT AFFAIRS COUNSELOR

WASHINGTON DC
+1.202.778.9223
MARY.BAKER@KLGATES.COM

