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Community Development Finance Alert

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Eligibility requirements for energy community bonus tax credits

By Forrest David Milder, Dana P. Stanton, and Kelly Sprague

Renewable energy developers and investors should look to recent guidance from the IRS that clarifies the requirements for claiming increased tax credits for renewable energy projects located in "energy communities."

What's the Impact?

- A significantly higher tax credit is available for projects in "energy communities," which include three categories: brownfields, tracts with coal-related closures, and statistical areas with fossil fuel employment.
- Qualification is determined annually—be aware that some qualifications could change year-over-year.

The Department of the Treasury and Internal Revenue Service (IRS) recently published Notice 2023-29 clarifying the eligibility requirements for claiming energy community bonus tax credits for renewable energy projects. The bonus credits are part of the Inflation Reduction Act of 2022 (IRA) for projects qualifying for renewable energy tax credits under sections 45 (production tax credit (PTC)), 45Y (clean energy production tax credit), 48 (investment tax credit (ITC)), and 48E

(clean electricity investment tax credit) and are worth up to an additional 10% if located in an "energy community."

The IRA provides a larger tax credit (10% higher in the case of Sections 45 and 45Y and ten percentage points higher in the case of Sections 48 and 48E) for certain renewable resources located in energy communities. For example, the 10% PTC adder might increase the credit to 3.025 cents per kWh, depending on whether other adders apply. On the other hand, the 10% ITC adder might increase the credit to 40%, depending on whether other adders apply. Of course, the ten-percentage point increase in the ITC from 30% to 40% is actually a 33% increase in the amount of the credit.

Is my project in an energy community?

Under the IRA, a project is in an energy community (eligible for the 10% adder) if it is included within ***any one*** of the following three categories:

- "**Brownfield Category**"—The project is in a brownfield, subject to certain exceptions.
- "**Statistical Category**"—At least one of the following two applies:
  - The project is in a metropolitan statistical area or a non-metropolitan statistical area with BOTH (a) at least .17% (that is 1 in 600) of the people employed in fossil fuels and (b) an unemployment rate at or above the national average.

  or
  - The project is in a metropolitan statistical area or a non-metropolitan statistical area with BOTH (a) more than 25% of its tax revenue derived from fossil fuel businesses and (b) an unemployment rate at or above the national average.
- "**Coal Closure Category**"—The project is in a census tract with a coal mine shut down after 1999 or a coal-fired electrical generator shut down after 2009, or an adjacent census tract.

A project must meet one or more of the three tests to qualify for the 10% adder.

Notice 2023-29 provides guidance regarding the rules for a project's eligibility as an energy community.

Brownfield Category

The IRA uses the definition of "brownfield site" from the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). CERCLA defines brownfield sites as 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. Although, at first glance, this is an expansive definition, CERCLA has a substantial list of types of contaminated properties that are excluded from the definition. In particular, the following types of contaminated properties are NOT brownfield sites:

- Listed, or proposed to be listed, on the National Priorities List (NPL)
- Subject to a unilateral administrative order, a court order, an administrative order on consent,

or a judicial consent decree issued under CERCLA, the Resource Conservation and Recovery Act (RCRA), the Clean Water Act (CWA), the Toxic Substances Control Act (TSCA), and/or the Safe Drinking Water Act (SDWA)

- Subject to corrective action under RCRA

Notice 2023-29 reiterates that the categories of contaminated properties excluded from CERCLA's definition of "brownfield site" are not eligible for the Brownfield Category. By relying on CERCLA's definition of "brownfield site," the IRA excluded many contaminated properties from eligibility for the Brownfield Category.

Notice 2023-29 also sets forth three "safe harbors." If a project fits within any one or more of these, the IRS will treat it as being in an energy community that qualifies for the 10% adder:

- **Previous Assessment Safe Harbor**. The site was previously assessed through federal, state, territory, or federally recognized Indian tribal brownfield resources as meeting the definition of a brownfield site under CERCLA. (Potential site lists may be found under the category of brownfields in the U.S. Environmental Protection Agency's database or a state database.)
- **Phase II Safe Harbor**. The site has a Phase II Environmental Site Assessment prepared in accordance with the current ASTM standard confirming the presence of a pollutant, contaminant, or hazardous substance.

  or

- **Phase I Safe Harbor**. For projects with a nameplate capacity of not greater than 5 megawatts (alternating current) the site has a Phase I Environmental Site Assessment prepared in accordance with the current ASTM standard.

Regarding the third category, language specifying the results of the Phase I Environmental Site Assessment is conspicuously absent. Stated differently, the first safe harbor requires an assessment as a brownfield, and the second safe harbor requires confirmation of the presence of a pollutant, contaminant, or hazardous substance. However, the third safe harbor only requires that there ***be*** a Phase I and not that it indicates that there is any problem or potential problem.

On the one hand, it seems unlikely that the IRS meant for any 5MW or smaller project to qualify for a 40% credit rate by simply ***seeking*** a Phase I. On the other hand, as the days go by without a change in this standard, we are likely to see at least some developers and investors claim reliance on the guidance as published. We'll note that the presence or potential of contamination appears to implicitly apply to all three safe harbor conditions under the IRA's overarching definition of brownfield site: 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. We anticipate that the IRS may revise Notice 2023-29 to require that the Phase I Environmental Site Assessment reach a conclusion that the property is less than pristine.

Importantly, Notice 2023-29 is expected to be only the first phase of guidance on the subject, and we anticipate IRS issuance of regulations and application materials that provide further information and clarification.

In sum, not every contaminated property will be eligible for the Brownfield Category, and an examination of whether an exclusion applies and what safe harbor condition to pursue will be necessary. In some situations, the exclusions and safe harbor will be relatively clear. In other situations, exploration of the facts and consultation with legal counsel and environmental consultants may be necessary.

Statistical Category

For the Statistical Category, the IRS tells us to use the North American Industry Classification System (NAICS) codes to identify which classes of employment are tested in apply the .17% test. The codes are as follows:

2017 NAICS CODE	DESCRIPTION
211	Oil and Gas Extraction
2121	Coal Mining
213111	Drilling Oil and Gas Wells
213112	Support Activities for Oil and Gas Operations
213113	Support Activities for Coal Mining
32411	Petroleum Refineries
4861	Pipeline Transportation of Crude Oil
4862	Pipeline Transportation of Natural Gas

Each May, the Treasury Department and the IRS intend to issue a listing identifying the metropolitan statistical areas (MSAs) and non-MSAs that qualify under the Statistical Category.

The alternative statistical test, based on fossil-fuel tax revenue, is in limbo; the IRS has asked for suggestions on how it might do these computations.

Note that the fossil fuel employment and unemployment rate tests are normally based on the data from the year before the year that the project is placed in service. There is also a grandfathering rule related to when the project began construction, discussed below.

Coal Closure Category

This category applies to a census tract with a coal mine shut down after 1999 or a coal-fired electrical generator shut down after 2009, or an adjacent census tract.

"Closed coal mine" means a coal mine classified as a surface or underground mine that has ever had, for any period of time, a mine status of abandoned or abandoned and sealed by the U.S. Department of Labor's Mine Safety and Health Administration (MSHA) in the Mine Data Retrieval System (MDRS). If a coal mine has "irregular location information," it will not be included, but taxpayers can seek to correct this.

"Retired coal-fired electric generating unit" means an electric generating unit classified as retired at any time since December 31, 2009, by the U.S. Energy Information Administration (EIA) of the U.S. Department of Energy in the Preliminary Monthly Electric Generator Inventory (EIA Form 860M) or the Electric Generator Inventory (EIA Form 860). If a generator has "irregular location information," it will not be included, but taxpayers can seek to correct this.

As stated above, this rule applies not only to a census tract with a coal mine shut down after 1999 or a coal-fired electrical generator shut down after 2009; it also applies to an ***adjacent census tract to such a census tract***. The Notice provides:

> Directly Adjoining. Census tracts are directly adjoining if their boundaries touch at any single point. There are many cases where multiple census tracts meet at a single point. If a closed coal mine or retired coal-fired electric generating unit is located in one of the census tracts, then other census tracts sharing the single point would be considered directly adjoining.

For the Coal Closure Category, the IRS has provided the most straightforward guidance of all—a 121-page list of eligible census tracts.

When are the determinations made?

For the PTC of Sections 45 and 45Y, the qualification of the facility is determined annually, "during any part of the taxable year" because the statutory language refers to where the project is "located." Thus, it appears that a facility relying on statistical areas could be qualified in one year and not in another, depending on how the data is compiled for the particular year. Because the coal closure category refers to mines that "ever had, for any period of time" an abandoned status after 1999 or generators classified as retired "at any time" after 2009, once a census tract is considered eligible, the tract should not lose that status in the future.

For the ITC of Sections 48 and 48E, the qualification of the facility is determined on the placed-in-service date, as provided by statute. This is a single determination that should not be affected by later data. However, this does mean that a developer or investor may be concerned that, having begun construction of what appears to be a qualifying project, it might nonetheless lose that status by the time it is placed in service.

Importantly, there is a **special rule**: If a taxpayer begins construction on or after January 1, 2023, in a location that is an energy community as of the "beginning of construction" date, then, with respect to that Project, the location will continue to be considered an energy community for the duration of the credit period for sections 45 and 45Y or on the placed-in-service date for sections 48 and 48E. (It should be noted, as originally published, the notice permitted taxpayers to use the year before they began construction even if the year construction started was before 2023. The IRS decided to limit this exception by adding the "on or after January 1, 2023" requirement in a slight modification to the Notice, made without any announcement from the IRS.)

What to do next?

Remember that a project must satisfy as little as ONE of the three tests to qualify for the energy community adder. In connection with the Brownfield Category, in particular, consultation with legal counsel and a technical consultant will be helpful to understand a project's potential eligibility.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

Forrest David Milder
617.345.1055
fmilder@nixonpeabody.com

Dana P. Stanton
518.427.2735
dstanton@nixonpeabody.com

Kelly Sprague
518.763.6670
ksprague@nixonpeabody.com