

Locke Lord QuickStudy: New IRS and Treasury Guidance on ?Energy Community Bonus ?Tax Credits Leaves as Many ?Questions as ?it Answers

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On April 4, 2023, the Department of Treasury (the “Treasury”) and the Internal Revenue Service (“IRS”) published [Notice 2023-29, Energy Community Bonus Credit Amounts under the Inflation Reduction Act of 2022](#) (“the Notice”), the long-awaited draft guidance on the bonuses available under the Inflation Reduction Act of 2022 (“IRA”) for the production tax credit (“PTC”) and the investment tax credit (“ITC”) for qualifying facilities (“EC Projects”) located in “energy communities”. While the Notice purports to address many of the most significant questions regarding how the various eligibility criteria are to be measured and applied, it unfortunately uses ambiguous language that makes it very difficult to determine how to apply many of the principles set forth in the Notice, which will make it challenging in many instances for renewable energy developers and their investors to be confident that a given project will qualify.

Two Tests for Determining Where an EC Project is Located

The Notice states that a project is deemed “located in” or “placed in service within” an energy community (and hence constitutes an EC Project eligible to claim the bonus tax credit) if it meets either the “Nameplate Capacity Test” or, for non-electric generating or storage facilities (e.g., a fuel production facility such as a biogas facility), the “Footprint Test.”

Under the Nameplate Capacity Test, a project qualifies if, based on the location of energy-generating units, at least 50 percent of its nameplate capacity “is in an energy community area.” This is determined by dividing the nameplate capacity of the project’s energy-generating units (*i.e.*, turbines or solar panels) that are “located in an energy community” by the total nameplate capacity of all the projects energy-generating units.

Under the Footprint Test, a project is considered located or placed in service within an energy community if at least 50 percent of the project’s square footage is situated in an energy community area.

The Notice states that a project that has a nameplate capacity (such as wind and solar projects) must apply the Nameplate Capacity Test, while a project that has no nameplate capacity (such as qualified biogas property) must apply the Footprint Test.

Energy Community Categories

The IRA defines three categories of “energy communities”, which the Notice labels and clarifies as follows:

1. “Brownfield Category”, consisting of any “brownfield site,” defined with reference to, but more narrowly than, the definition of “brownfield site” in the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (“CERCLA”).
2. “Statistical Area Category”, consisting of a metropolitan statistical area (“MSA”) or a non-metropolitan statistical area (“non-MSA”) that (A) has (or at any time after 1999 had) 0.17 percent or greater direct employment, or 25 percent or greater local tax revenues derived from the extraction, processing, transport, or storage of coal, oil, or natural gas (respectively, the “Fossil Fuel Employment” requirement and “Fossil Fuel Tax Revenue” requirement); and (B) has an unemployment rate at or above the national average unemployment rate for the previous year (the “Unemployment Rate” requirement). The Notice clarifies that a project qualifies as located in an energy community if it is located in an MSA or non-MSA that, at any time since 2009, has had at least 0.17 percent employment or 25 percent local tax revenue derived from the fossil fuel industry *and* a local unemployment rate for the previous year that exceeded the national average. The IRS provided a complete list of all MSAs and non-MSAs (regardless of qualification under the Statistical Area Category) in Appendix A to the Notice, found [here](#). The IRS also explained the methodology it used to calculate historic fossil fuel employment and provided a chart of those statistical areas the IRS believes fall in this category in Appendix B to the Notice, found [here](#). Given the complexity involved in this test, the IRS has specifically requested public comment to help it formulate rules for this test. The Treasury and IRS have also released a mapping tool to assist in the determination, available on the Department of Energy’s website, [here](#).
3. “Coal Closure Category”, comprised of census tracts (or directly adjoining census tracts) where a coal mine closed after 1999, or a coal-fired electric generating unit was retired after 2009. A project qualifies as located in or placed in service within an Energy Community if it is located in a census tract (or directly adjoining census tract) where either a coal mine has closed after 1999 or a coal-fired electric generating unit has closed after 2009. The Notice clarifies that a mine is considered closed if, at any time since 1999, it had the status of “closed” or “abandoned” in the U.S. Department of Labor’s Mine Safety and Health Administration in the Mine Data Retrieval System. A coal-fired electric generating unit is considered retired if the unit has, since 2009, been classified as retired by Energy Information Administration. The IRS provided a table of the census tracts it considers as meeting this test, found [here](#). The Treasury and IRS have also released a mapping tool to help this determination, found [here](#).

Both the Nameplate Capacity Test and the Footprint Test apply to projects located in any of these three categories. A threshold question when determining whether a project is “within an energy community” for purposes of either of the tests is how one defines the boundaries of the “energy community area.” While those boundaries are clear for purposes of the Statistical Area Category, which relies upon designated MSAs and non-MSAs, and the Coal Closure Category, which relies upon defined census tracts, the Brownfields Category lacks such clarity. This makes it very difficult to determine whether a project that seeks to qualify under the Brownfields Category in fact meets the Nameplate Capacity Test or the Footprint Test, since the Notice provides no guidance on how the boundaries of the “energy community area” are to be drawn for purposes of those tests. This is an issue that begs to be addressed in the final rule, and ideally in a clarification issued prior to that. Similar questions plague interpretation of the safe harbors that the Notice establishes for the Brownfields Category, as discussed below.

Safe Harbors Under the Brownfield Category

A brownfield site, as defined in CERCLA, 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 (as defined under 42 U.S.C. § 9601) and certain mine-scarred land (as defined in 42 U.S.C. § 9601(39)(D)(ii)(III)). Excluded from the definition of a brownfield are properties described in 42 U.S.C. § 9601(39)(B), which include

sites subject to government orders, consent decrees, or certain other requirements under CERCLA and other federal environmental statutes.

To aid in determining eligibility of brownfield projects for the energy communities bonus credit, the Notice creates a “safe harbor” for the Brownfield Category under which eligible properties can automatically qualify as a brownfield site if one of the following three conditions is satisfied:

1. 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 42 U.S.C. § 9601(39)(A). These sites can be identified on the U.S. Environmental Protection Agency webpage “[Cleanups in My Community](#)” or similar online databases maintained by states, territories, or tribes.
2. A Phase II Environmental Site Assessment (Phase II ESA) has been completed with respect to the site in accordance with the most recent version of the Standard Practice for Phase II ESAs, ASTM E 1903. In addition, the Phase II ESA must confirm the presence on the site of a hazardous substance as defined under 42 U.S.C. § 9601(14) or a pollutant or contaminant as defined under 42 U.S.C. § 9601(33).
3. For small projects with a nameplate capacity of five megawatts AC or less, a Phase I Environmental Site Assessment (Phase I ESA) must have been completed under the most recent version of the Standard Practice for Phase I ESAs, ASTM E1527-21.

The first safe harbor condition is awkwardly phrased, and it is unclear what exactly it means for a site to have been “assessed ... as meeting the definition of a brownfield site,” particularly in the case of non-federal brownfield sites. Most state brownfield programs (e.g., voluntary cleanup programs) do not formally designate a site as a “brownfield.” If a site requires cleanup or closure due to the presence of hazardous substance contamination, a person may enter the site into the state’s brownfield program and as long as the site meets the relevant eligibility criteria it will be accepted into the program. The Notice does not explain whether this safe harbor is meant to include any site that has been entered into any state program, whether it applies only to sites entered into state brownfield incentive programs, or whether a site must somehow be formally designated as a “brownfield” for the safe harbor to apply. For example, it is unclear if a site that is in a state’s standard corrective action program, as opposed to that state’s voluntary cleanup program, would qualify for this safe harbor.

The second safe harbor condition (regarding Phase II ESAs) raises two important, unanswered questions. The first question concerns the meaning of the phrase “with respect to the site”: How does the IRS propose to define the “site” for purposes of this safe harbor? A typical wind energy project may consist of dozens of leased parcels, which together are colloquially referred to as the “project site.” Hence, by definition, a “project site” always includes 100 percent of the nameplate capacity and footprint of a project. But whereas Phase I ESAs are generally performed for the entire project site and not for individual parcels, when a Phase II ESA is called for it typically focuses on specific areas within the project site. Depending on the nature and scope of the suspected impacts prompting the Phase II, the Phase II ESA may be confined to a single parcel or it may encompass several parcels. It would seem to be the case that whenever a Phase II ESA confirms the presence of contamination on *any* portion of the project site, no matter how limited, it would result in the project meeting the Nameplate Capacity Test or the Footprint Test, as applicable, because the Phase II was performed for a portion of the project site and, as noted above, the project site by definition includes all of the generating units. If, on the other hand, the IRS intends for “on the site” to mean only those areas actually affected by contamination for purposes of the Nameplate Capacity and Footprint Tests, then very few (if any) sites are likely to qualify other than mine-scarred lands, because projects are rarely built in areas with such extensive contamination. This is especially true for wind projects with footprints that cover tens of thousands of acres, but also for solar projects covering hundreds of

acres instead of thousands.

The second question raised by the Phase II safe harbor condition concerns the Notice's reliance on the ASTM E 1903 standard. While Phase I ESAs are almost always conducted in compliance with the ASTM E 1527 standard, in practice Phase II ESAs rarely reference or explicitly follow the ASTM E 1903 standard because Phase IIs are by nature bespoke assessments. So, if the presence of hazardous substance has been confirmed on a portion of a project site through Phase II sampling, is that not sufficient to qualify for the safe harbor if the Phase II does not fully conform to the ASTM standard? Or is the intent of this condition to put form over function and require that a Phase II ESA be performed in conformance with the process set forth in ASTM E 1903, even though that is by no means necessary to detect the presence of hazardous substance releases?

Finally, the third safe harbor condition, applicable to projects of 5 MW or less, simply requires that an ASTM-compliant Phase I "has been completed with respect to the site." This once again raises the question of what constitutes a "site". In addition, it is notable that the Notice's plain language requires merely that a Phase I ESA has been completed, not that the Phase I has identified any Recognized Environmental Conditions (RECs) suggesting the presence or potential presence of a release of hazardous substances. In other words, as currently drafted, this safe harbor would enable every 5 MW project to qualify as an EC Project whether or not any contamination is present, because Phase Is are performed for virtually every project as a matter of course (and as a condition of financing). While that would certainly be beneficial to the industry, it is questionable whether such a result is consistent with the Congress' intent in creating the energy communities provision in the IRA. While some have speculated that the finding of a REC is an implicit requirement of the Phase I safe harbor condition, there is no such indication in the Notice and no justification for the IRS to impose a condition that is not explicit in its own guidance.

Conclusion

The IRA promises to provide historic stimulus to renewable energy development in the U.S. The energy communities provision is one of the most significant tools for accomplishing that goal and one of the areas where guidance has been most sorely needed and eagerly anticipated. The Notice, while helpful in some regards, unfortunately fails to provide the level of clarity and certainty needed for taxpayers to determine whether their projects, particularly those relying on the Brownfields Category, constitute EC Projects that qualify for the bonus credit.

The IRS intends to issue formal, proposed regulations that, when finalized, will apply to taxable years after April 4, 2023. In the meantime, the IRS says taxpayers may rely on the guidance set forth in the Notice, and it is accepting comments on the Notice until May 4 to help inform the proposed regulations. Renewable energy developers, investors and lenders would be wise to submit comments seeking further clarification of these issues.

For questions regarding the IRA or the Notice, or to discuss the energy communities issues further, please contact the authors or any member of Locke Lord's renewable energy team.

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