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Locke Lord QuickStudy: That Sinking Feeling: IRS Energy ?Communities Guidance May Limit Eligibility of Many ?Offshore ?Wind Projects

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In an ongoing series related to the Inflation Reduction Act ("IRA"), we have been looking at key provisions of the IRA with the potential to benefit the U.S. offshore wind industry. On April 5, 2023, the IRS issued Notice 2023-29 (the "Notice"), which provides guidance related to the Energy Community bonus credit under §§ 45, 45Y, and 48E of the IRA. In broad terms, the Energy Community credit is intended to provide increased credit amounts or rates for qualified facilities, energy projects or energy storage technologies that meet certain requirements. In our previous QuickStudy we explored some of the questions that remain despite the guidance contained in the Notice, and in some cases because of it, particularly in relation to the brownfields category. This QuickStudy addresses aspects of the Notice relating to offshore wind projects, following up on our earlier QuickStudy, *Brownfields and the Deep Blue Sea: ?Offshore Wind Development and the IRA's Energy ?Communities ?Provisions*.

As we noted in that earlier QuickStudy, the definition of an "Energy Community" under the IRA wholly failed to consider offshore wind as a potential source of "qualified energy property." That fact did not go unnoticed by offshore wind developers, a large number of whom submitted comments to the IRS, proposing a range of potential clarifications to the scope of the "Energy Community" definition to ensure that offshore wind was not deprived of the potential ten percent bonus credit available under the Energy Community provision. Some commenters proposed applying the IRS' existing concepts of Enterprise Zones ("EZs") (?(IRC §1397C(f)) and Qualified Opportunity Zones ("QOZs") (IRC §§1400z-1 and 1400z-2)? to offshore wind to permit ?projects to claim the Energy Community bonus credit where the offshore wind project is constructed ?in a location contiguous to or containing property straddling an Energy Community, and ?that portion of the energy project constructed on land designated as an Energy Community ?exceeds the portion of the land-based project located outside of an Energy Community. Others? proposed that if any part of an energy project is located in an Energy Community, the ITC or PTC ?should be increased by the percentage of the relative capitalized construction cost, nameplate ?generation, or area by acreage that is located in an Energy Community. Still others ?focused their eligibility proposals on the location of an offshore wind project's interconnection ?facility, where the project's power will be settled, the location of port facilities used to stage, ?crew, construct and maintain the offshore wind farm, or some combination of these factors, with ?varying views as to the extent to which each of these elements should qualify for the credit. ?

With its issuance of the Notice, the IRS significantly narrowed the field of offshore wind development projects that may be able to claim the Energy Community bonus credit. Sections 45 and 45Y of the IRA state that in order to be eligible for the Energy Community bonus credit a qualified facility must be "located in" an Energy Community. Sections 48 and 48E similarly state that an energy project, qualified facility, or energy storage technology must be

“placed in service” within an Energy Community to qualify for the Energy Community bonus credit. The Notice sets forth guidance for determining whether the “location” requirement is met. For projects with defined nameplate generating capacities such as offshore wind projects, the guidance calls for application of a test based on a project’s nameplate capacity:

(1) Nameplate Capacity Test: Under the Nameplate Capacity Test, an EC Project that has nameplate capacity is considered located in or placed in service within an energy community if 50 percent or more of the EC Project’s nameplate capacity is in an area that qualified as an energy community. An EC Project’s nameplate capacity percentage is determined by dividing the nameplate capacity of the EC Project’s energy-generating units that are located in an energy community by the total nameplate capacity of all the energy-generating units of the EC Project.

The IRS then goes on to specifically address offshore wind for the only time in the Notice, further clarifying how the Nameplate Capacity test is to be applied to offshore wind projects:

(2) Nameplate Capacity Attribution Rule. If an EC Project with offshore energy generation units has nameplate capacity but none of the EC Projects energy-generating units are in a census tract, MSA (metropolitan statistical area) or non-MSA, then the Nameplate Capacity Test for such EC Project is applied by attributing all the nameplate capacity of such EC Project to the land-based power conditioning equipment that conditions energy generated by the EC Project for transmission, distribution, or use and that is closest to the point of interconnection.

While at first blush proponents of offshore wind development may be heartened by the express inclusion of offshore wind in the Notice, thereby confirming the industry’s eligibility for the Energy Community bonus credit, upon closer consideration this Nameplate Capacity Attribution Rule raises questions as to how many offshore wind projects will actually be able to qualify for the Energy Community bonus credit. The Nameplate Capacity Attribution Rule essentially precludes any offshore wind project from claiming the bonus credit unless it has an onshore electrical substation that is located in an Energy Community. While future projects that are early in their project development timeline may be able to deliberately site their substation in a qualifying Energy Community area, for those projects in advanced stages of development that are already committed to a substation location outside of a qualifying Energy Community, the bonus credit may be out of reach.

Perhaps the bigger consideration, however, is that by basing eligibility for offshore wind projects solely on the location of the onshore substation, the IRS has missed the opportunity to incentivize project developers to prioritize Energy Communities for significant capital investment. Developers have limited flexibility in choosing locations for onshore substations due to a number of factors, most notably the importance of available transmission interconnection. Thus, it simply may not be feasible for a project developer to locate its substation in an Energy Community area despite the incentive to do so that the availability of the bonus credit would otherwise provide. On the other hand, offshore wind developers have much greater flexibility in selecting the location of various other onshore components of their projects, but the Nameplate Capacity Attribution Rule removes any incentive that the availability of the bonus credit would have otherwise provided for them to do so. For example, port sites are critical to the success of the fledgling U.S. offshore wind industry and frequently qualify as brownfields due to contamination from heavy industrial operations. Had the IRS adopted a test that allowed for attribution of other onshore facilities to the Nameplate Capacity Test besides just the substation, it could have driven significant additional investment in and redevelopment of these blighted port sites. Similarly, offshore wind

developers must make significant investments in workforce development and supply chain manufacturing. If those investments counted towards a project's eligibility determination it could have driven developers to target areas in the Statistical Area and Coal Closure categories of Energy Communities for those investments, providing significant economic benefits to those communities and the people in them.

The unfortunate limitation of the availability of the Energy Communities bonus credit only to those offshore wind projects that can locate their onshore substation in an Energy Community represents a missed opportunity both to drive the onshore portion of the investment to locations and communities where it is most needed, and to support the growth of the offshore wind industry by making available to it the same bonus credit that many onshore projects will readily be able to claim. The IRS is accepting comments on the Notice until May 4 to help inform its proposed regulations. Offshore wind developers should consider submitting comments in an effort to expand their access to the bonus credit.

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

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