June 2023

Follow @Paul_Hastings

Treasury Issues Additional Guidance on Low-Income Community Bonus Credit

By Michael Haun, Kami LaBerge, Lena Son & Crist Malekyan

On June 1, 2023, the Treasury Department ("Treasury") issued a notice of proposed rulemaking including proposed rules (the "Proposed Rules") regarding the "Low-Income Communities Bonus Credit Program" established by the Inflation Reduction Act of 2022 (the "IRA").

Under the IRA's modifications to the investment tax credit ("ITC") available under Section 48 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), a "qualified solar and wind facility" (*i.e.*, a facility that generates electricity solely from a wind facility, solar energy property, or small wind energy property that has a maximum net output of less than 5 MW and that meets certain location requirements) that receives an allocation of environmental justice solar and wind capacity limitation ("Capacity Limitation") will be eligible for a 10 percentage point or 20 percentage point increase in the energy percentage with respect to any eligible property that is part of the facility (such increase, the "Low-Income Communities Bonus Credit").

The Proposed Rules supplement the guidance issued by the Internal Revenue Service ("IRS") in February in Notice 2023-17 to outline specific application procedures, additional allocation criteria, and applicable definitions necessary for an owner of a facility to submit an application to request an allocation of Capacity Limitation for the 2023 calendar year.

I. Qualification for the Low-Income Communities Bonus Credit and Capacity Allocation

Under the IRA, the total annual Capacity Limitation that may be allocated under the Low-Income Communities Bonus Credit Program is 1.8 gigawatts of direct current capacity for each of the calendar years 2023 and 2024.

Consistent with Notice 2023-17, the Proposed Rules propose that for 2023, the allocation of Capacity Limitation reserved for each qualifying facility category is as follows:

Category	Qualifying Facility Type	Capacity Limitation
Category 1:	**Located in a low-income community**. A "low-income community" is a population census tract that (a) has a poverty rate of at least 20%, or (b)(i) in the case of a tract not located within a metropolitan area, the median family income for that tract does not	700 MW

	exceed 80% of the statewide median family income or (ii) in the case of a tract located within a metropolitan area, the median family income for that tract does not exceed 80% of the greater of the statewide median family income or the metropolitan area median family income.	
Category 2:	**Located on Indian land**. Indian land is "Indian land" as defined in Section 2601(2) of the Energy Policy Act of 1992.	200 MW
Category 3:	**Qualified low-income residential building project**. A facility will be treated as part of a "qualified low-income residential building project" if (a) it is installed on a residential rental building that participates in an affordable housing program[1] and (b) the financial benefits of the electricity produced by the facility are allocated equitably among the occupants of the dwelling units of that building.	200 MW
Category 4:	**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 that facility are provided to households with income of (a) less than 200% of the poverty line applicable to a family of the size involved or (b) less than 80% of area median gross income.	700 MW

II. Proposed Definitions and Requirements

A. Definition of a "Facility"

To qualify for the Low-Income Communities Bonus Credit, a qualifying facility must have a maximum net output of less than 5 megawatts (as measured in alternating current). In the Proposed Rules, Treasury expressed concern that applicants may attempt to circumvent this requirement by artificially dividing larger projects into multiple facilities. To prevent this, the Proposed Rules state that multiple solar or wind energy properties or facilities that are operated as part of a single project must be aggregated and treated as a single facility. Whether multiple facilities or energy properties are operated as part of a single project depends on the relevant facts and circumstances and will be evaluated based on the factors provided in Section 7.01(2)(a) of Notice 2018-59 or Section 4.04(2) of Notice 2013-29, as applicable, which include:

- ownership by a single legal entity;
- construction on contiguous pieces of land;
- description in a common power purchase agreement;
- having a common intertie;
- sharing a common substation;
- description in one or more common environmental or other regulatory permits;

- construction under a single master construction contract; and
- construction financed under the same loan agreement.

B. Energy Storage Technology Installed in Connection with Solar and Wind Facility

For facilities that qualify for the Low-Income Communities Bonus Credit, the energy percentage with respect to any energy property that is part of that facility is increased by 10 percentage points (for facilities in Categories 1 and 2) or 20 percentage points (for facilities in Categories 3 and 4). "Eligible property" is defined in the statute to include energy property that meets certain requirements, including energy storage technology installed in connection with that energy property.

Under the Proposed Rules, energy storage technology is "installed in connection with" energy property if both:

1. the energy storage technology and energy property are considered part of a single qualified solar and wind facility because the energy storage technology and other eligible property are (i) owned by a single legal entity, (ii) located on the same or contiguous pieces of land, (iii) have a common interconnection point, and (iv) are described in one or more common environmental or other regulatory permits; and

2. the energy storage technology is charged no less than 50% by the energy property.

The Proposed Rules also include a safe harbor under which energy storage technology is deemed to be charged at least 50% by the facility if the power rating of the energy storage technology is less than 2 times the capacity rating of the connected facility (in kW alternating current for wind facilities and in kW direct current for solar facilities).

C. Meaning of "Financial Benefits" for Category 3 and Category 4 Allocations

1. <u>Financial Benefits for Qualified Low-Income Residential Building Projects</u>

For a facility to be treated as part of a "qualified low-income residential building project," the financial benefits of the electricity produced by the facility must be allocated equitably among the occupants of the dwelling units of the building on which the facility is installed.

Treasury has proposed in the Proposed Rules that a "financial benefit" for these purposes can be demonstrated through net energy savings. To show this, at least 50% of the financial value of net energy savings must be equitably passed on to building occupants. The Proposed Rules define the net energy savings differently for scenarios in which facilities have the same ownership as the building than for scenarios in which facilities have different ownership as the building.

- *Facility and building have same ownership*. The financial value of net energy savings is the financial value equal to the greater of (1) 25% of the gross financial value of the annual energy produced by the facility or (2) the gross financial value of the annual energy produced by the facility, *minus* the sum of annual debt service, maintenance, replacement reserve, and other costs incurred to maintain and operate the facility (*i.e.*, the annual cost to operate the facility). For purposes of these calculations, the gross financial value of the annual energy produced by a facility is the sum of (a) the total self-consumed kilowatt-hours produced by the facility *multiplied by* the applicable building's metered price of electricity and (b) the total exported kilowatt-hours produced by the facility *multiplied by* the applicable building's volumetric export compensation rate for solar and wind kilowatt-hours.

- *Facility and building have different ownership and facility owner enters into power purchase agreement with building owner*. Net energy savings is equal to the greater of: (1) 50% of the financial value of the annual energy which accrues to the building owner in the form of utility bill credit and/or cash payments for net excess generation or (2) the financial value of the annual energy produced by the facility which accrues to the building owner in the form of utility bill credit and/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.

Each scenario requires the execution of certain agreements. If the facility and building have the same ownership, a signed benefits sharing agreement between the owner and the tenants is required. If they do not have the same ownership, the facility owner must enter into an agreement with the building owner for the building owner to distribute the savings to residents.

The Proposed Rules also address the impact of metering on the delivery of financial benefits:

- *Sub-metered buildings*. For sub-metered buildings, tenants must receive the financial value associated with utility bill savings in the form of a credit.

- *Master-metered buildings*. For master-metered buildings in which residents do not have individually metered utilities, the building owner must pass on the savings in other ways, such as by providing benefits to building residents beyond those provided prior to the facility being placed in service.

Treasury and the IRS are aware that in some state or local jurisdictions, it may not be administratively (or even legally) possible to apply utility bill savings on residents' electricity bills, and they have requested comments on this issue.

2. <u>Financial Benefits in Qualified Low-Income Economic Benefit Projects</u>

For a facility to be treated as part of a "qualified low-income economic benefit project," at least 50% of the financial benefits of the electricity produced by that facility must be provided to households below certain income thresholds.

Under the Proposed Rules, to satisfy this standard, (a) the facility serves multiple households and (b) at least 50% of the facility's total output be distributed to qualifying low-income households.

In addition, Treasury has proposed to reserve allocations under Category 4 exclusively for applicants providing at least a 20% bill credit discount rate for qualifying low-income households. The "bill credit discount rate" can be calculated by dividing (a) the difference between (i) the financial benefit distributed to the low-income household and (ii) payments made by the low-income customer to the facility owner and any related third parties as a condition of receiving that financial benefit by (b) the financial benefit distributed to the low-income household.

The Proposed Rules impose verification requirements with respect to households' qualifying low-income status and suggest methods to verify the households' income either through categorical eligibility or other income verification methods.

D. Meaning of "Located In" for Facilities Straddling a Qualifying Geographic Area

Categories 1 and 2 require that a facility be "located in a low-income community" or "on Indian Land," respectively (each as described above). Neither the IRA nor Notice 2023-17 addressed whether a facility that is located partially within and partially without a qualifying geographic area would qualify under this rule.

Under the Proposed Rule, a facility is located in a qualifying geographic area if it satisfies a nameplate capacity test. The nameplate capacity test requires that 50% or more of the facility's nameplate capacity be in the qualifying geographic area. That percentage is determined by dividing the nameplate capacity of the facility's energy-generating units that are located in the qualifying geographic area by the total nameplate capacity of all the energy-generating units of the facility.

This nameplate capacity test mirrors the nameplate capacity test the IRS introduced in Notice 2023-29 with respect to the energy community bonus credit.[2]

III. Proposed Program Requirements and Structure

The Proposed Rules outline specific application procedures and additional allocation criteria.

A. Placement in Service Before Allocation Award Is Not Permitted

Notice 2023-17 provided that facilities placed in service before receiving an allocation of Capacity Limitation will not be eligible to receive the allocation. The Proposed Rules reiterate this limitation.

B. Selection Process & Additional Selection Criteria

Under the IRA, the amount of the Capacity Limitation that may be allocated pursuant to Code Section 48(e)(4) is limited to 1.8 gigawatts of direct current capacity for each of calendar years 2023 and 2024, and zero thereafter.

Notice 2023-17 provided that applications would be accepted in a phased approach for calendar year 2023. Treasury stated that it believes the number of eligible applicants may exceed the total Capacity Limitation allocation available, and thus the Proposed Rules offer a modified approach: There will be an initial application window with a set deadline, after which all applications received by that deadline will be evaluated together. Following that initial application window, there will be a rolling application process if Capacity Limitation is not fully allocated. At least 50% of the total Capacity Limitation in each facility category would be reserved for facilities satisfying the additional selection criteria. Facilities that satisfy one of the two additional selection criteria will receive allocation priority, but if eligible applications for facilities satisfying one of the additional criteria exceed the Capacity Limitation for a category, facilities satisfying both of the additional selection criteria will receive allocation priority. If a category is oversubscribed, the remaining applicants will be placed into a lottery system.

Treasury has proposed two additional selection criteria:

1. *Ownership criteria*. The ownership criteria category is based on characteristics of the applicant that owns the facility (or, if the applicant is disregarded, its regarded owner). A facility would meet the ownership criteria if it is owned by any of the following:
   - A tribal enterprise, defined as an entity that is at least 51% owned by an Indian Tribal government and for which the Indian Tribal government has the power to appoint and remove more than 50% of the entity's board of directors;

- An Alaska Native corporation (as defined in the Alaska Native Claims Settlement Act);
- A renewable energy cooperative, defined as an entity that develops qualifying facilities and is either (i) a consumer or purchasing cooperative controlled by members who are low-income households, or (ii) a worker cooperative controlled by its worker-members, in each case, with members having equal voting rights;
- A qualified renewable energy company, defined as an entity that serves low-income communities and provides pathways for the adoption of clean energy by low-income households, meeting certain characteristics; or
- A qualified tax-exempt entity.

2. *Geographic criteria*. The geographic criteria category is based on where the facility is placed in service. A facility would meet the geographic criteria if it is located in:
   - A Persistent Poverty County, defined as any 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 greater than or equal to the 90th percentile for either energy burden or PM2.5 exposure and greater than or equal to the 65th percentile for low income.

C. Sub-Reservations of Allocation for Facilities Located in Low-Income Communities

Notice 2023-17 and the Proposed Rules provide that 700 MW of 2023 calendar year Capacity Limitation will be reserved for Category 1 (low-income communities). The Proposed Rules further subdivide this 700 MW Capacity Limitation reservation:

- *Residential behind the meter facilities*. 560 MW will be reserved for eligible residential behind the meter (BTM) facilities, which are defined as single-family or multi-family residential qualified solar and wind facilities that do not meet the requirements for Category 3 and are BTM.
- *Front of the meter and non-residential behind the meter facilities*. The remaining 140 MW will be reserved for front of the meter facilities and non-residential behind the meter facilities.

D. Required Documentation and Attestations

The Proposed Rules set forth additional documentation that must be provided and attestations that must be made by owners applying for an allocation and upon placement-in-service of the facility.

E. Post-Allocation Compliance

1. <u>Disqualification After Receiving an Allocation</u>

The IRA requires that an applicant place a facility in service within four years after the date of an allocation of Capacity Limitation to that facility. Treasury recognized in the Proposed Rules that within this four-year window, circumstances might change prior to the facility being placed in service such that the facility is no longer eligible for the allocation it received. The Proposed Rules therefore set forth circumstances under which a facility that was awarded a Capacity Limitation allocation will be disqualified from receiving that allocation 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 (i) increases such that it exceeds the less-than-5 MW alternating current output limitation or (ii) decreases by the greater of 2 kW or 25% of the Capacity Limitation awarded in the allocation;
- If in Category 3 or 4, the facility cannot satisfy the applicable financial benefits requirement as planned;
- 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
- The facility received a Capacity Limitation based, in part, on meeting the ownership criteria, and ownership of the facility changes before the facility is placed in service such that the ownership criteria are no longer met, unless (i) the original applicant retains an ownership interest in the entity that owns the facility and (ii) the successor owner attests that after the 5-year recapture period, the original applicant will become the owner of the facility or will have a right of first refusal.

2. Recapture

Code Section 48(e)(5), as introduced by the IRA, requires Treasury to provide rules for the recapture of the benefit of any Low-Income Communities Bonus Credit with respect to a facility that ceases to be property eligible for the Low-Income Communities Bonus Credit. The period and percentage of the recapture must be determined under rules similar to the rules of Code Section 50(a), which provides for a recapture of 100% of the applicable credit if the recapture event occurs in the first year after a facility is placed in service, with that percentage decreasing by 20% in each subsequent year.

Treasury has proposed in the Proposed Rules that the following circumstances would result in a recapture event:

- If the facility is in Category 3 or 4, the facility fails to provide applicable financial benefits over the 5-year recapture period;
- If the facility is in Category 3, the financial benefits of the electricity produced by the facility cease to be allocated equitably among the occupants of the dwelling units;
- If the facility is in Category 4, less than 50% of the financial benefits of the electricity produced by the facility is provided to qualifying households or those households are not provided with the required minimum 20% bill credit discount rate;
- If the facility is in Category 3, the residential rental building the facility is a part of ceases to participate in a covered housing program or other eligible housing program; or
- The facility increases its output such that the facility's output is 5 MW AC or greater, unless the applicant establishes that the output increase is not attributable to the original facility but

rather is output associated with a new facility under the 80/20 Rule described in Revenue Ruling 94-31.

IV. Applicability and Future Guidance

The Proposed Rules are proposed to apply to tax years ending on or after final rules adopting the Proposed Rules are published in the Federal Register. Treasury has requested public comments on all aspects of the Proposed Rules by June 30, 2023. After the comment period closes, Treasury will consider the input it receives and whether revisions to the Proposed Rules are warranted.

Notice 2023-17 stated that the IRS anticipated that it would begin to accept applications for Categories 3 and 4 beginning in the third quarter of 2023. In light of the proposed modifications to the selection process in the Proposed Rules, it is unclear whether this anticipated timeframe has been extended. Additional IRS guidance is needed to address when the initial application window will close. In the meantime, the Proposed Rules provide project developers with guidance to evaluate whether their projects may qualify for an allocation, although Proposed Rules may change in response to comment, and additional selection criteria or other requirements may ultimately be implemented.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Los Angeles lawyers:

Michael D. Haun
1.213.683.6119
michaelhaun@paulhastings.com

Kami LaBerge
1.213.683.6159
kamilaberge@paulhastings.com

Lena Son
1.213.683.6115
lenason@paulhastings.com

[1] An "affordable housing program" includes (i) a covered housing program under the Violence Against Women Act of 1994; (ii) a housing assistance program administered by the Department of Agriculture under Title V of the Housing Act of 1949; (iii) a housing program administered by a tribally designated housing entity; and (iv) other affordable housing programs as the Treasury Secretary may provide.

[2] For a discussion of the energy community bonus credit, see https://www.paulhastings.com/insights/client-alerts/irs-guidance-issued-on-energy-community-bonus-credit.