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Proposed Regulations for Low-Income Community Solar/Wind Tax Credit Introduce New Priority Criteria

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On May 31, the Treasury Department issued proposed regulations (**REG-110412-23**) detailing how small solar and wind facilities located in or connected to low-income communities (LIC) can qualify for the so-called Low-Income Communities Bonus Energy Investment Credit Program (the Program, which is memorialized in Tax Code Section 48(e) and was established by the Inflation Reduction Act of 2022). In particular, the guidance proposes a new approach to the selection process for 2023—including the introduction of new priority criteria—after receiving feedback on the delayed implementation and phased approach outlined in earlier Internal Revenue Service (IRS) guidance (the LIC Notice, **Notice 2023-17**, see **our earlier alert**).

Key Points

- Rolling application period replaced previously proposed application windows.
- At least half of the total amount available for allocation is expected to be reserved for applicants meeting additional ownership or location criteria, which will be awarded by lottery if oversubscribed. All other applications will be subject to IRS discretion in the case of oversubscription.
- 560 megawatt (MW) set aside for behind-the-meter residential solar in Category 1 (location based).
- Community solar required to provide 20% bill discounts and verify income.
- Includes key definitions related to the calculation of financial benefits, aggregating facilities for purposes of the 5 MW size limit, including a battery in a facility, determining the location of a facility and providing financial benefits to low-income building tenants.
- Requires applicants to submit site control documentation, an interconnection agreement and an attestation regarding site control, permitting and project sizing. Applicants also required to submit a permission-to-operate letter or commissioning report, a Professional Engineers (PE) stamped as-built plan, third-party verification of nameplate capacity and subscriber or low-income building tenant information.
- Provides guidance on recapture and allows a single one-year cure period per facility beginning upon actual or constructive knowledge of noncompliance.

For purposes of allocating bonus amounts of “environmental justice solar and wind capacity limitation” to certain facilities in 2023 (increasing their available section 48(a) energy investment tax credit), the regulations propose to do away with the suggested 60-day application windows, replacing them with one initial application window (followed by a rolling application process only if the capacity limitation isn’t fully allocated after the initial window closes). Importantly, only those facilities that meet at least one of **two new additional selection criteria** would receive priority for an allocation (facilities meeting both get super priority).

Although these proposed regulations contains substantive threshold definitions and requirements applicable for the 2023 capacity limitation allocations, the majority of information regarding the program will be issued later this year, when the Treasury anticipates releasing procedural rules for submitting an application to request an allocation of 2023 capacity limitation under the Program. Facilities placed in service prior to being awarded an allocation of capacity limitation are generally not eligible to receive an allocation.

In general, any facility that generates electricity solely from wind, solar or small wind energy property that has a maximum net output of **less than 5 MW** of alternating current and that is one of the following four facility categories may be eligible for an allocation (note that only Category 3 and 4 facilities are eligible for the highest increase—20 percentage points instead of just 10 percentage points—in the credit amount). The portion of the total annual capacity limitation reserved for each category for 2023 is listed to the right:

Category 1: Facilities located in a low-income community (700 MW)

Category 2: Facilities located on Indian land (200 MW)

Category 3: Qualified low-income residential building project (200 MW)

Category 4: Qualified low-income economic benefit project (700 MW)

Facilities receiving a bonus credit allocation must be placed in service within four years.

New Priority Selection Criteria (Ownership and Geographic)

The Treasury is proposing two additional selection criteria that will confer priority in receiving an allocation under the Program for 2023. Applicants that meet both the Ownership Criteria and the Geographic Criteria would receive super priority (which would occur only if the capacity limitation for a category is exceeded by eligible applicants that meet only one of the additional selection criteria). The Treasury is proposing to set aside **at least half** of the total capacity limitation in each category for facilities meeting the additional selection criteria (setting up a lottery system for any oversubscribed categories and retaining discretion to reallocate the limitation in certain cases).

The Ownership Criteria is satisfied if the facility is owned by a Tribal Enterprise, an Alaska Native Corporation, a "renewable energy cooperative," a "qualified renewable energy company" meeting certain characteristics or a "qualified tax-exempt entity" (with special rules in the case of disregarded entities). Although each of these terms is defined in the proposed guidance, we expect the term that will be most of interest to Program applicants is what constitutes a "qualified renewable energy company." According to the proposed regulations, a "qualified renewable energy company" would need to satisfy the following requirements:

1. At least 51% of the company's equity interests must be owned and controlled by (a) one or more individuals, (b) a Community Development Corporation, (c) an agricultural or horticultural cooperative, (d) an Indian Tribal government, (e) an Alaska Native corporation or (f) a Native Hawaiian organization;
2. After applying the controlled group rules under section 52(a) of the Code, the company must have less than 10 full-time equivalent employees and less than $5 million in annual gross receipts in the previous calendar year;
3. The company must have first installed or operated a qualified solar and wind facility two or more years prior to the date of application; and
4. The company must have installed and/or operated qualified solar and wind facilities with at least 100 kilowatts (kW) of cumulative nameplate capacity located in one or more Low-Income Communities.

Further, the Treasury has indicated an interest in proposing a rule that would ensure that "qualified renewable energy companies" are employing workers in low-income communities.

The Geographic Criteria is satisfied if the facility is placed in service in a Persistent Poverty County (PPC) or in a census tract that is designated in the Climate and Economic Justice Screening Tool (CEJST) as disadvantaged. A PPC is generally defined as any county where 20% or more of the residents have experienced high rates of poverty over the past 30 years (tied to U.S. Department of Agriculture data). A census tract is designated as disadvantaged based on whether the tract is either (a) 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 (b) greater than or equal to the 90th percentile for fine particles (Particulate Matter 2.5) exposure and is greater than or equal to the 65th percentile for low income (with all of this tested at the time of application, unless the location of the facility changes).

Category 1 Allocations to Be Further Subdivided

The Treasury and the IRS expect that Category 1 (facilities located in a low-income community) will receive the most applications, largely for small rooftop residential solar facilities. Therefore, the Treasury and the IRS are proposing to subdivide the 700 MW capacity limitation for 2023 so that 560 MW of such allocation will be reserved for small rooftop residential behind-the-meter (BTM) facilities. The remaining 140 MW would be available for applicants with front-of-the-meter (FTM) facilities and non-residential BTM facilities. Further definitions of these qualifying facilities are provided in the guidance.

Defining "Facility," "In Connection With" and "Located In"

The proposed regulations state that the Treasury and the IRS "are concerned that some applicants may attempt to circumvent the less than 5-megawatt output limitation . . . by artificially dividing larger projects into multiple facilities" in order to qualify for the bonus credit. Therefore, they propose to aggregate into a single facility multiple facilities of the same type (solar or wind) operated as part of a single project consistent with the factors provided in **Notice 2018-59** (which contains beginning-of-construction rules for solar facilities) or **Notice 2013-29** (which contains beginning-of-construction rules for wind facilities).

In general, the bonus credit is available for energy property that is part of a qualifying solar or wind facility, including energy storage technology "installed in connection with" such qualifying energy property. Under this proposal, energy storage technology would be "installed in connection with" other eligible property only if (1) the energy storage technology and the other eligible property are considered part of a single qualified solar or wind facility (that is, they are owned by a single legal entity, located on the same or contiguous pieces of land, have a common interconnection point, and are described in one or more common permits); and (2) the energy storage technology is charged no less than 50% by the other eligible property (where, under a safe harbor, energy storage technology would be deemed to be charged at least 50% by the facility if the power rating of the storage technology is less than two times the capacity rating of the connected facility).

Location of the facility matters for purposes of categories 1 and 2 (facilities located in a low-income community or located on Indian land), and such location is established by way of the so-called Nameplate Capacity Test. Under this test, a facility is considered located in or on the relevant geographic area if 50% or more of the facility's nameplate capacity is in a qualifying area (determined after dividing the nameplate capacity of the facility's energy-generating units located in the qualifying area by the total nameplate capacity of all of the energy-generating units of the facility).

Defining "Financial Benefit" and "Electricity Acquired at Below Market Rate"

The bonus credit for qualified low-income residential building projects (Category 3) is only available if the financial benefits of the electricity produced by the facility are allocated equitably among the affordable housing program occupants. The Treasury is proposing that this requirement can be satisfied as long as at least 50% of the "financial value of the net energy savings" is equitably (either by low-income unit or by each unit's electricity usage) passed on to the building's occupants (with the remainder benefitting energy consumption associated with common areas, for example).

"Financial value of net energy savings" is proposed to be defined as follows:

- If the solar/wind facility and the qualified low-income residential building are under common ownership, then the value of net energy savings equals the greater of (1) 25% of the gross financial value of the annual energy produced; or (2) the gross financial value of the annual energy produced minus the annual costs to the operate the facility (where "gross financial value of the annual energy produced" includes both the total self-consumed kilowatt-hours produced by the solar/wind facility multiplied by the building's metered price of electricity and the total exported kilowatt-hours produced by the solar/wind facility multiplied by the building's volumetric export compensation rate for solar/wind kilowatt-hours). "Annual operating costs" would include annual debt service, maintenance and replacement reserve.
- If the facility and building have different owners, and the facility enters into a power purchase agreement of other energy services contract with the building owner, then the value of net energy savings equals the greater of (1) 50% of the financial value of the annual energy that is produced by the facility and that accrues to the building owner in the form of a utility bill credit and/or cash payments for net excess generation; or (2) 100% of the financial value of the annual energy that is produced by the facility and that accrues to the building owner in the form of a utility bill credit and/or cash payments for net excess generation minus any payments made by the building owner throughout the year to the facility owner for building-related energy services. The facility owner would need to enter into an agreement requiring the building owner to pass the savings onto the residents.

The Treasury and the IRS request comments on how to account for payments from the building occupants to the facility owner for energy services when determining "financial value."

In both cases, the owner(s) would need to enter into a signed benefits sharing agreement requiring them to pass the utility bill savings onto the residents. However, the Treasury and the IRS acknowledge that in master-metered buildings and in certain sub-metered buildings, it is either impossible or administratively infeasible to distribute the financial benefits to residents via adjustments to metering. Therefore, in certain cases, they propose to require that the financial value of the utility bill savings be distributed to tenants in the form of a credit on their electricity bills. In cases where tenants don't receive electricity bills, the building owner will be required to pass the savings on through other means. Applicants are directed to follow the U.S. Department of Housing and Urban Development (HUD) guidance to ensure that such savings distributions do not impact utility allowance and annual income for rent calculation purposes.

With respect to the 50% threshold (50% of the financial benefits of the electricity produced must be allocated to qualifying low-income tenants), the Treasury and the IRS propose that eligible buildings must be multi-family and that at least 50% of the facility's total electricity output be distributed to qualifying low-income households (defined in section 48(e)(2)(C)(i) or (ii)). Note that applicants would be required to submit documentation with proof-of-income verification and the kW output allocated with respect to each household. Further, the Treasury and the IRS are proposing that Category 3 allocations be reserved to only those applicants that are able to provide at least a 20% "bill credit discount rate" for all such households. "Bill credit discount rate" is determined by taking the financial benefit distributed to the low-income household (either through bill credits, rate reductions or other monetary benefits), subtracting out the cost of participating in the program (including payments made by the low-income household to the facility owner for the renewable energy) and dividing that amount by the financial benefit distributed to such household.

Demonstration of Facility Viability

In order to ensure that facilities awarded a bonus credit are sufficiently viable, the Treasury and the IRS are proposing to require applicants to submit certain documentation and attestations that vary based on the category and additional selection criteria. However, all facilities will be required to provide a copy of the executed contract to purchase/lease the facility (or a copy of the executed power purchase agreement), along with attestations that the applicant has site control, has obtained the necessary permits, is in compliance with all applicable laws, has appropriately sized the facility to meet no more than 110% of historical consumer load, and has inspected the installation site for suitability.

Disqualification Prior to Placement In Service and Recapture

The guidance contains procedures to ensure post-allocation compliance and, if circumstances change such that a facility is no longer eligible, provisions for recapture of the credit increase. In particular, the Treasury acknowledged that because an applicant has four years after being allocated a capacity limitation to place in service eligible property, certain changes to the project that occur between allocation and placed-in-service could result in disqualification. Namely, if:

- The location of the facility changes;
- The nameplate capacity either increases beyond the 5 MW size limit or decreases by the greater of 2 kW or 25% of the awarded capacity limitation;
- The applicable financial benefits requirements aren't satisfied;
- The placed-in-service deadline isn't met; or
- The ownership of the facility changes such that the ownership criteria are no longer satisfied (with certain exceptions);

Then the Treasury and the IRS will disqualify the facility from receiving the allocation (the section 48(a) energy investment credit is generally claimed in the tax year in which the property is placed in service). Additionally, subject to certain period and percentage rules, the Treasury and the IRS can recapture the benefit of the credit increase after it's already been claimed if the property ceases to be eligible. Namely, if:

- The financial benefits (for Category 3 and Category 4 projects only) aren't realized over the five-year period after the placed-in-service date;
- For Category 3 projects only, the financial benefits aren't equitably allocated among the building occupants;
- For Category 4 projects only, the property ceases to provide at least 50% of the financial benefits to qualifying households (or fails to provide those households the required minimum 20% bill credit discount rate);
- For Category 3 projects only, the property ceases to participate in a covered housing program; or
- The facility increases its output beyond the 5 MW size limit (with certain exceptions).

Then the Treasury/IRS will deem a recapture event. However, if within 12 months of the date that the applicant should be aware that the property has ceased to be eligible for the credit increase, the property's eligibility is restored, then recapture may not apply (but this relief is only available once).

Comments on REG-110412-23 are due by June 30, 2023. In particular, the Treasury is interested in hearing whether these proposed rules should also apply for 2024 allocations and for the program to be established under section 48E(h) for 2025 and future years. We encourage you to contact one of the below attorneys if you have questions regarding this IRS guidance.

If you need assistance or have questions regarding this alert, please contact your Akin relationship attorney or one of the authors:

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