ROSENBLUM GOLDENHERSH

MEMORANDUM

TO: Client
FROM: Brian J. Beck
DATE: February 24, 2023
RE: Energy Credit Opportunities for Tax-Exempt Entities

The Inflation Reduction Act (signed into law on August 16, 2022) modified existing and created new tax credit incentives for a wide range of clean energy technologies. These incentives are a significant upgrade from the prior energy tax credit programs, which had been the subject of ongoing phase-out and extension cycles over the past 20 years. The IRA also introduced a number of new concepts to the clean energy tax rules, some of which are summarized below.

Federal Labor Standards Requirements Unless less than 1 megawatt

First, for the Section 48 energy credit (and most other energy credits), projects generating 1 megawatt (AC net output) or more must pay prevailing wages and meet apprenticeship requirements to earn the "full base" credit amount.[1] The base credit amount is 30% of the costs of the energy property. If the labor standards are not met on projects of 1 megawatt or more then the credit percentage is reduced to 6%.

Direct Payment Election for Refund

Additionally, prior to the IRA, many tax-exempt entities, which often owe little or no federal tax payments, could not benefit from available energy credits. In order to promote broad-based investment in clean energy, the IRA allows certain tax-exempt entities (such as "any State or political subdivision thereof" or tax exempt organizations) to elect to claim a refund from the IRS equal to 100% of the amount of credit.[2] The IRS needs to issue further guidance, but the statutory language indicates the claim must be made on an income tax return or in the case of a government or political subdivision that doesn't file a tax return as determined by the IRS. The IRS requested comments for guidance in November 2022, and the industry is hopeful for further guidance soon.

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[1] See e.g. [Prevailing Wage and Apprenticeship Requirements for Tax Credits (thomsonreuters.com)].

[2] The payment amount is reduced to 90% of the credit for projects that don't begin construction before 2024, unless the project size is less that 1 megawatt of AC net output or otherwise meets the labor requirements (prevailing wage/apprenticeship). The direct pay or "refund" is not unrelated business taxable income (UBTI) to the tax-exempt entity.

Bonus Credits Percentages

Further, there are now several bonus credits or "boosts" available to projects that meet certain criteria. There are now boosts of 10% for projects in an energy community (including brownfield properties),[3] 10% for projects that meet domestic content requirements,[4] and 10-20% for solar or wind projects located on affordable housing projects or in low-income communities (same definition as for the NMTC program[5]). The 10-20% solar/wind bonus for affordable housing or low-income community properties will be awarded by application to the IRS/Department of Energy starting in Q3 2023.[6] The boosts are stackable, so in theory a project could receive a 70% credit. But even a 30-50% credit that can be claimed as a 100% refund could be a great subsidy for green building.

Tax-Exempt Financing Reduction

The Section 48 energy credit is reduced to the extent the project is financed with tax-exempt bonds, up to a maximum reduction of 15 percent.[7] For example, a project financed completely with tax-exempt debt that would otherwise qualify for a 30 percent investment tax credit would instead be eligible for a 25.5 percent credit.

Recapture Liability

The energy credits claimed (i.e. the direct payment creating the refund) are still subject to "similar rules" for recapture in the event the project falls out of compliance under the energy credit regulations during the compliance period (generally 5 years after placement in service).

Other Resources
https://www.mossadams.com/articles/2023/01/tax-credits-for-renewable-energy-entities

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[3] A partial map of "energy communities" eligible for the automatic 10% bonus to the 30% energy credit was released by the DOE here: https://arcgis.netl.doe.gov/portal/apps/experiencebuilder/experience/?id=09457c326145417595287951ed376a29. This map doesn't have all areas that are included in the "energy communities" definition yet (brownfields, certain eligible MSA and non-MSA are not yet included).

[4] Generally, all steel and iron must be produced in US, and at least 40% of the "total costs of all such *manufactured products* of such facility [that] are attributable to manufactured products (including components) which are mined, produced, or manufactured" must be from the US. First Solar Inc., one of the largest US solar panel manufacturers, announced in February 2023 that it awaits IRS guidance to qualify its panels for the domestic content bonus.

[5] See e.g. this map: https://www.novoco.com/resource-centers/new-markets-tax-credits/data-tools/nmtc-mapping-tool

[6] The latest announcement is available here: https://www.energy.gov/articles/biden-harris-administration-announces-historic-investments-support-americas-energy-and

[7] Section 45(b)(3) and 48(a)(4) refer to a reduction in the amount which is the product of the amount so determined for such year and the lesser of 15 percent or a fraction-

(A) the numerator of which is the sum, for the taxable year and all prior taxable years, of proceeds of an issue of any obligations the interest on which is exempt from tax under section 103 and which is used to provide financing for the qualified facility, and

(B) the denominator of which is the aggregate amount of additions to the capital account for the qualified facility for the taxable year and all prior taxable years.

The amounts under the preceding sentence for any taxable year shall be determined as of the close of the taxable year.

https://www.energy.gov/eere/solar/federal-solar-tax-credits-businesses
https://www.arnoldporter.com/en/perspectives/advisories/2023/02/inflation-reduct-act-oppor-for-tax-exempt-entities
https://www.prpa.org/wp-content/uploads/2022/08/08.25.2022-combined-handouts.pdf