Hogan Lovells

Tax update

June 15, 2023

This is a commercial communication from Hogan Lovells. See note below.

The Inflation Reduction Act's new guidance on the low-income communities bonus credit program

Under the Inflation Reduction Act ("**IRA**"), the investment tax credit ("**ITC**") may be increased if the applicable energy property qualifies for certain bonus levels, including an increased ITC energy percentage of up to 10% or 20% for qualified solar and wind facilities placed into service in, or to benefit, low-income communities. Initial guidance on the low-income communities bonus program (the "**Program**") was released in February 2023 in Notice 2023-17, and last month the Treasury Department released a notice of proposed rulemaking which expands upon, and makes some important changes to, the initial guidance.

The tax credits and other incentives in the IRA have been a game changer for a number of industries, including energy of course. However, the real estate industry should pay particular attention to the Program, since many real estate projects incorporating solar energy property are likely to qualify if they are in the right place on the map! If you are putting solar panels on the roof, especially for a smaller project, the Program could increase the ITC energy percentage when calculating your tax credit.

This update focuses primarily on the 10% bonus available for energy facilities located in low-income communities and on Indian Land, so please reach out directly to discuss any questions on the 20% bonus available for qualified low-income residential projects and qualified low-income economic benefit projects.

Highlights of new changes in the proposed rules

- When evaluating whether a facility does not exceed the maximum net output limit of 5 MW, multiple facilities in a single project may be aggregated to prevent abuse.
- Rather than a "first come first served" application process, all applications received in an initial application window will be considered together. A rolling application process may follow if there is excess capacity not fully allocated during the initial application window.
- Certain facilities may have priority, or even "super priority" for an allocation.
- After the allocations are awarded, projects may be disqualified before they are placed in service, and the bonus ITC amounts are also subject to recapture.

1. Qualified solar and wind facilities

For purposes of the 10% bonus, a qualified solar and wind facility:

- Generates electricity solely from a wind facility or solar energy property, although energy storage technology (i.e., batteries) may also be included;
- Has a maximum net output of less than 5 MW; and
- Is located in a low-income community or on Indian land.

What types of energy storage technology qualifies under the Program?

Energy storage technology installed in connection with other qualifying wind or solar property may qualify under the Program. Under the proposed rules, energy storage property will be considered to be installed in connection with other eligible property if:

- Both the energy storage technology and the other eligible property are considered part of a single qualified solar and wind facility (because they are owned by a single legal entity, located on the same or contiguous pieces of land, share an interconnection point, and are described on the same environmental or other regulatory permit); and
- The energy storage technology is charged no less than 50% by the other eligible property.

When will multiple facilities be aggregated into a single project for purposes of the 5 MW output limit?

Multiple facilities of the same type may be aggregated if they are operated as part of a single project as determined based on various factors including whether they are owned by the same legal entity, are constructed on contiguous pieces of land, share a common intertie and substation, are described in common power purchase agreements and regulatory permits, and were financed pursuant to the same loan agreement.

What does it mean for a facility to be "located in" a low-income community or on Indian land?

A facility is considered to be located in the relevant area if 50% or more of the facility's nameplate capacity is in the qualifying area, determined by dividing the nameplate capacity of the facility's energy-generating units located in the qualifying area by the total nameplate capacity of the all of the facility's energy-generating units.

If my project meets these requirements, do I automatically get the 10% bonus?

No, you must apply for an allocation of capacity. Unlike some of the other bonus levels created by the IRA (domestic content, energy communities), the Program is capped at a specific capacity amount.

2. Allocations of capacity

In Notice 2023-17, Treasury established the Program to allocate capacity to qualified wind and solar facilities. For 2023, there is 1.8 GW of capacity that is divided amongst 4 categories.

Category	Capacity limitation
1: Located in a low-income community	700 MW
2: Located on Indian land	200 MW
3: Qualified low-income residential project	200 MW
4: Qualified low-income economic benefit project	700 MW

Facilities compete for allocations within their own categories, so a facility located in a low-income community will be evaluated separately from a facility located on Indian land. Under the proposed rules, applications received during the initial application window will be evaluated together, and if the capacity limitations are not fully allocated during the initial window, rolling applications will be accepted.

What if there are more applications than the capacity limitation available to be awarded in a particular category?

Priority is given to applications that meet at least one of two additional selection criteria – ownership criteria and geographic criteria. If there is still insufficient capacity for all applications, then super priority is given to applications that meet both additional selection criteria. A lottery system may be used in oversubscribed categories.

How can my project satisfy the additional selection criteria?

A facility will meet the ownership criteria if the facility is owned by Indian tribal governments meeting certain criteria, Alaska native corporations, renewable energy cooperatives, qualified tax-exempt entities, or qualified renewable energy companies that meet certain ownership requirements and other specific criteria including serving low-income communities. A facility will meet the geographic criteria if the facility is located in a persistent poverty county, or in a census tract designated as disadvantaged in the climate and economic justice screening tool.

If my facility is not awarded an allocation, can I appeal?

No.

Will qualified facilities placed in service prior to receiving allocations be considered?

No, facilities that are already placed in service will not be eligible for an allocation.

Will all Category 1 applications be similarly evaluated?

Treasury expects that Category 1 will receive the most applications. Under the proposed rules, the 700 MW capacity would be further subdivided. 560 MW would be reserved for residential "behind the meter" facilities, such as rooftop solar. The other 140 MW would be reserved for "front of the meter" facilities.

3. Timeline and next steps

The proposed rules are an important step forward for the Program, and for stakeholders in the energy and real estate communities. Once applications open and allocations are awarded, you have four years after the date of an allocation to place the property into service.

When can I apply for an allocation of capacity?

Treasury stated in the proposed rules that additional details would be released later this year for the 2023 allocation.

If I receive an allocation and place the energy facility into service within four years, is there any risk to claiming the bonus ITC?

Yes, a project can be disqualified under certain circumstances. Certain material changes can disqualify a facility, including changes to the location of the facility, increases to the nameplate capacity in excess of 5 MW, decreases in nameplate capacity in excess of specified amounts, changes in ownership, and a failure to place the property into service within four years.

Can the ITC bonus amounts be recaptured?

Yes, certain events can trigger a recapture. For the 10% ITC bonus, the main trigger would be certain increases in nameplate capacity over 5 MW. Note that there is a one-time cure right for recapture events.

What if I have comments to the proposed rules?

Treasury wants to hear from you! Comments are due by June 30th. Reach out if you would like to know more or need assistance in drafting your comment letters.

This Tax Update is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions about the IRA or the Program, or would like any additional information, please contact your relationship partner at Hogan Lovells or any of the lawyers listed in this update.

Contributors

Jessica Millett
Partner, New York
T +1 212 918 8247
jessica.millett@hoganlovells.com

Sherry Haoran Gui
Summer Associate, New York
T +1 212 918 3249
sherry.gui@hoganlovells.com

Alicante
Amsterdam
Baltimore
Beijing
Berlin**
Birmingham
Boston
Brussels
Budapest*
Colorado Springs
Denver
Dubai
Dublin
Dusseldorf
Frankfurt
Hamburg
Hanoi
Ho Chi Minh City
Hong Kong
Houston
Jakarta *
Johannesburg
London
Los Angeles
Louisville
Luxembourg
Madrid
Mexico City
Miami
Milan
Minneapolis
Monterrey
Munich
New York
Northern Virginia
Paris
Philadelphia
Riyadh*
Rome
San Francisco
São Paulo
Shanghai
Shanghai FTZ*
Silicon Valley
Singapore
Sydney
Tokyo
Ulaanbaatar*
Warsaw
Washington, D.C.

*Our associated offices
**Legal Services Center

www.hoganlovells.com