KPMG report: Initial observations on Notice 2023-29 guidance on determining energy communities for IRA tax credits

The U.S. Treasury Department and IRS on April 4, 2023, released Notice 2023-29, providing guidance relating to the potential additional tax credit amounts available for locating a project in an "energy community." The notice indicates that the rules provided are intended to be issued as forthcoming proposed regulations which will apply to tax years ending after April 4, 2023, but the notice also notes that taxpayers may currently rely on the rules set forth in the notice.

Background

H.R. 5376 (commonly called the "Inflation Reduction Act of 2022" (IRA)) made significant modifications and enhancements to the tax incentives available to clean energy. Included in those changes are opportunities to claim additional credit amounts ("adders") in certain situations, such as locating projects in so-called "energy communities."

The energy community adder applies to the section 48 or 48E investment tax credit (ITC) or section 45 or 45Y production tax credit (PTC) for eligible facilities located in or placed in service within an "energy community." The energy community adder increases a facility's otherwise applicable PTC rate by 10% or increases a project's ITC rate by 10 percentage points.[1]

An energy community can be one of three categories of locations: (1) Brownfield Category, (2) Statistical Area Category, and (3) Coal Closure Category.

Notice 2023-29 overview and mapping tool

The notice provides information around how the different energy community categories are determined and the relevant data used for those determinations. The notice also provides implementation guidance relating to how to apply the energy community category parameters to different situations.

In connection with the notice, Treasury and the IRS have coordinated with the Department of Energy (DOE) to provide a **mapping tool** that can illustrate the location of some of the energy communities, using the determination methodologies outlined in the notice. Note that at this time the mapping tool does not provide a complete listing of the eligible Energy Communities. Specifically, it currently displays locations in the Coal Closure Category under current data, and it also displays Statistical Areas that may be eligible, but such eligibility is subject to additional data, discussed in more detail in the description of Statistical Areas below. Several **FAQs** were also issued along with the notice and mapping tool.

[1] Or 2 percentage points in if the Prevailing Wage and Apprenticeship requirements are not satisfied.

KPMG observation

The availability of a mapping tool is welcome news and will hopefully eliminate the need for taxpayers and advisors to try to create their own versions. That said, the mapping tool that is currently available is limited only to identifying locations in the Coal Closure Category. It displays locations that may eligible Statistical Areas but further data is needed to refine that location set. And the mapping tool does not display locations in the Brownfield Category. FAQs accompanying the mapping tool note that the map will be updated in May 2023 when certain unemployment data becomes available and any corrections to the Coal Closure Category will also be reflected in the update.

Brownfield Category

Brownfield sites are defined in subparagraphs (A), (B), and (D)(ii)(III) of Section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). The notice also provides a safe harbor for Brownfield Category qualification based either on prior certification as a brownfield site or through designation via an ASTM E1903 Phase II Environmental Site Assessment (Phase II Assessment) or an ASTM E1527 Phase I Environmental Site Assessment (Phase I Assessment) for smaller facilities.

Statistical Area Category

This category includes a Metropolitan Statistical Area (MSA) or non-Metropolitan Statistical Area (non-MSA) that: (1) has (or had at any time after December 31, 2009) 0.17% or greater direct employment (Fossil Fuel Employment) or 25% or greater local tax revenues (Fossil Fuel Tax Revenue) related to the extraction, processing, transport, or storage of coal, oil, or natural gas (as determined by the Secretary of the Treasury or her delegate (Secretary)), and (2) has an unemployment rate at or above the national average unemployment rate for the previous year (as determined by the Secretary).

The notice provides clarity on various aspects of the Statistical Area Category. In particular, the notice describes the determination methodologies for the location of MSAs or non-MSAs, as well as standards for measuring an applicable location's relative employment from the fossil fuel power industry and its unemployment rate. The notice does not, however, provide guidance on the determination of fossil fuel tax revenue for an MSA or non-MSA and instead requests comments on this determination.

The notice provides the following additional information on the various criteria for the Statistical Area Category:

- MSAs are determined in accordance with Office of Management and Budget (OMB) standards, which are updated every 10 years in accordance with the US census process. Non-MSAs are determined in accordance with U.S. Bureau of Labor Statistics (BLS) standards. The notice includes a list setting forth delineations of MSAs and non-MSAs.
- The level of employment from the fossil fuel industry in an MSA or non-MSA is determined via 2017 North American Industry Classification System (NAICS) industry codes. The notice lists the MSAs and non-MSAs satisfying this standard.
- An MSA's or non-MSA's unemployment rate is determined by using county-specific Local Area Unemployment Statistics published by the BLS and aggregating figures across the counties located in such MSA or non-MSA.
- The notice explains that unemployment data for a year is not available until April the following year and therefore Treasury and IRS intend to annually publish a listing of MSAs and non-MSAs satisfying the fossil fuel industry employment standard each May.

KPMG observation

The notice indicates that the Fossil Fuel Tax Revenue component of the Statistical Area Category requires further information and analysis. The notice requests comments on this specific point and notes that comments should be submitted by May 4, 2023.

Coal Closure Category

The Coal Closure Category consists of census tracts in which after December 31, 1999, a coal mine has closed, or after December 31, 2009, a coal-fired electric generating unit has been retired, or a census tract that is directly adjoining such census tract.

A coal mine is identified for this purpose if it is or has been in the Department of Labor's Mine Safety and Health Administration's (MSHA's) "**Mines**" data set after December 31, 1999, with a type of "Surface" or "Underground."

A mine will be identified as "closed" if after Dec. 31, 1999 it has ever been listed in MSHA's Mines dataset as having a status of "Abandoned" or "Abandoned and Sealed." The map showing the census tracts that have had coal mine closures since 1999 and census tracts directly adjoining to such census tracts is based on MSHA's Mines dataset as of February 7, 2023. Historical versions of MSHA's Mines dataset are also used to identify mines that have ever had, since December 31, 1999, a status of "Abandoned" or "Abandoned and Sealed."

The notice states that a retired coal-fired electric generating unit for purposes of Energy Community definitions includes an "electric generating unit" classified as retired at any time since December 31, 2009, by the Energy Information Administration (EIA) of the U.S. Department of Energy in the Preliminary Monthly Electric Generator Inventory (EIA Form 860M) or the Electric Generator Inventory (EIA Form 860), depending on the year retired. The unit must be categorized as a coal-fired electric generating unit at the time it is listed as retired.

Finally, the notice provides that census tracts are considered directly adjoining if their boundaries touch at any single point. Thus, if a closure occurred in one of the census tracts, the other census tracts sharing the single point would be considered directly adjoining.

Located or placed in service in an energy community

Under sections 45 and 45Y, a qualified facility must be "located in" an energy community, and under sections 48 and 48E an energy project, qualified facility, or energy storage technology, as applicable, must be "placed in service" within an energy community, to qualify for the bonus credit amounts or rates.

For purposes of sections 45 and 45Y, whether a qualified facility is located in an energy community is determined separately for each tax year of the qualified facility's 10-year credit period. For purposes of sections 45 and 45Y, a qualified facility is treated as located in an energy community during a tax year if it is located in an energy community during any part of the tax year.

For purposes of sections 48 and 48E, whether an energy project is placed in service within an energy community is determined as of the placed-in-service date.

The notice provides that a project is “located in” or “placed in service within” an energy community (and thus eligible for the adder) if it satisfies a test based on relative nameplate capacity in an energy community or, for non-electricity-generating property (such as biogas) or storage projects, a footprint test.

Under the nameplate capacity test, a project is considered located or placed in service within an energy community if at least 50% of the facility’s nameplate capacity is in an energy community area based on the location of energy-generating units. For projects that convert direct current (DC) to alternating current (AC), the DC nameplate capacity is used. Otherwise, the AC nameplate capacity is used.

The notice provides that for offshore wind projects, the determination is based on the location of facility’s land-based power conditioning equipment for transmission, distribution, or use that is nearest to the point of interconnection (such as a substation).

Under the footprint test, a facility is considered located or placed in service within an energy community if at least 50% of the facility’s square footage is situated in an energy community area.

KPMG observation

The capacity and footprint tests will have to be carefully considered in situations where projects are or will be located partly in energy communities and partly outside of energy communities.
The special rule for projects located offshore will likely be welcome news. Absent such a special rule, many considered the energy community adder unavailable for offshore wind projects.

Beginning of construction safe harbor

The notice provides a “begin construction” safe harbor that deems a facility to be located in an energy community for the year in which a facility is placed in service and for the entirety of the 10-year PTC period, if applicable. Specifically, if a taxpayer “begins construction” in a location that is an energy community on its beginning of construction date, the location will continue to be considered an energy community for the duration of the PTC period or on the ITC placed in service date, as applicable. This safe harbor applies to projects on which construction began on or after January 1, 2023. The notice provides that existing begin construction rules apply for purposes of this safe harbor.

KPMG observation

The begin construction safe harbor will provide welcome certainty to many projects, especially PTC eligible projects which otherwise would have to determine its energy community eligibility for each of the 10-year credit period.

The requirement that projects need to have begun construction on or after January 1, 2023, in order to have the safe harbor apply was not included in the initial version of the notice, rather it was added later as a correction. The use of this date may raise questions and feedback from taxpayers, as many may have started trying to locate energy communities and plan projects accordingly starting shortly after the enactment of the IRA (August 16, 2022), including for projects already under construction as of the date of enactment.

Conclusion

The notice brings welcome clarity to an important aspect of the IRA credit provisions. For many projects certainty on the determination of energy communities had become a sticking point in project development, with inconsistent data and interpretations at play. The guidance provided in the notice, as well as the mapping tool and associated FAQs, should resolve many of the concerns and uncertainty in these determinations. In the near-term, taxpayers should anticipate the promised May 2023 unemployment data updates and associated updates to the mapping tool. And farther out, the issuance of this guidance as proposed regulations will be closely watched, especially for any material changes to the rules and methodologies provided in the notice.

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