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Renewable Energy Tax Credits under the Inflation Reduction Act: Opportunities for Exempt Organizations

The Inflation Reduction Act of 2022 (the "IRA" or "Act") added and modified several renewable energy tax provisions under the Internal Revenue Code of 1986, as amended (the "IRC").[1] These changes provide many opportunities for exempt organizations, investors, and developers in clean energy projects to lower their costs by monetizing previously unavailable tax credits and thereby increase their business. Among them:

- Solar facilities are now eligible for the Section 45 Production Tax Credit
- An Investment Tax Credit for stand-alone energy storage technology with a minimum capacity of 5 kWh
- A new two-tier credit system consisting of a base credit and an additional bonus credit for eligible projects that satisfy new prevailing wage and apprenticeship requirements
- New "domestic content," "energy community," and "low-income community" bonus credits
- New "technology neutral" tax credits
- New ways to monetize tax credits

There has been significant interest in the energy credits by tax exempt organizations, in particular by universities and hospitals. Indeed, these organizations have been looking to minimize their greenhouse gas impact or carbon footprint with the goal of achieving clean energy even prior to the enactment of the IRA. The direct pay option which is now available under the IRA has accelerated the interest in clean energy. Commentators also note that private foundations have been interested in addressing climate change and taking advantage of these newly enacted credits to help spread the use of clean technologies.

Section 6417, discussed below, could be a "game changer" in this regard. Even though certain of the credits have been in existence, unless tax exempts have had a significant amount of unrelated business income tax ("UBIT"), they previously could not avail themselves of the credits prior to the enactment of Section 6417 which provides the direct payment alternative.

The below will outline the new and modified renewable energy tax credits under the IRA, and summarize recent guidance issued by the Treasury Department.

CHANGES TO EXISTING TAX CREDITS

Section 45 Production Tax Credit

Before the enactment of the IRA, the Section 45 Production Tax Credit ("PTC") was available to electricity produced from certain renewable resources, including wind, biomass, geothermal, hydropower, municipal solid waste, and marine and hydrokinetic energy. Under the Act, solar facilities and are now also eligible for the PTC. In order to qualify for the PTC, eligible facilities must be placed in service and start construction before the end of 2024. Facilities which begin construction after December 31, 2024, will fall under the new technology-neutral tax credit regimes (discussed below).

Section 48 Investment Tax Credit[2]

Prior to the Act, the Section 48 Investment Tax Credit ("ITC") was not available to stand-alone energy storage projects. The IRA created an ITC for stand-alone energy storage technology with a minimum capacity of 5 kWh. The term "energy storage technology" includes any technology that receives, stores, and delivers energy for conversion to electricity, or to most technology that thermally stores energy.

Like the PTC, under the Act, eligible facilities can qualify for the ITC as long as they are placed in service and begin construction before the end of 2024. Facilities which begin construction after December 31, 2024, will fall under the new technology-neutral tax credit regimes (discussed below).

STRUCTURAL CHANGES TO THE TAX CREDIT SYSTEM

The IRA created a new two-tier credit system consisting of a base credit and an additional bonus credit that is only available for eligible projects that satisfy the new prevailing wage and apprenticeship requirements (discussed below). The new ITC base rate will be 6 percent, and the bonus rate will increase it to 30 percent. The new PTC base rate will be 0.3 cents/kwh and the bonus rate will increase it to 1.5 cents/kwh.

Prevailing Wage Requirement

Taxpayers must pay laborers, mechanics, contractors, and subcontractors a prevailing wage during the construction of the project and with respect to subsequent alterations or repairs of the project following its placement in service. The prevailing wage is based on the pay rates published by the Department of Labor ("DOL") for the geographic areas and type of job or labor classification. If relevant pay rates are not published, the taxpayer must request a wage determination or wage rate from the DOL.[3]

Apprenticeship Requirement

Taxpayers must also ensure that, with respect to the construction of a qualified facility, no fewer than the "applicable percentage" of total labor hours are performed by qualified apprentices. The "applicable percentage" is: (i) 10 percent for projects beginning construction before 2023, (ii) 12.5 percent for projects beginning construction during 2023, and (iii) 15 percent for projects beginning construction thereafter. Each contractor and subcontractor who employs four or more individuals to perform construction on an applicable project must employ at least one qualified apprentice. A "qualified apprentice" is an individual who is employed by the taxpayer or any contractor or subcontractor and who is participating in a registered apprenticeship program.

If a taxpayer fails to satisfy the apprenticeship requirement during a particular year, the taxpayer may correct the failure by paying a penalty to the IRS equal to $50 ($500 if the apprenticeship requirement was intentionally disregarded) multiplied by the total number of labor hours that did not satisfy the apprenticeship requirement. However, the IRA also includes a "good faith effort" exception if the taxpayer requests qualified apprenticeships from a registered apprenticeship program and either the request is denied, or the program fails to respond within five business days after receiving the request.

ADDITIONAL BONUS CREDITS

The IRA established the "domestic content," "energy community," and "low-income community" bonus credits.

Domestic Content

Projects qualifying for certain PTC and ITC credits could qualify for a 10 percent increase to the base and bonus credits if they satisfy the IRA's new "domestic content" requirements. To qualify for this bonus credit, all steel, iron, and manufactured products that are components of the completed facility are to be produced in the United States.

Energy Community

Facilities located in an "energy community" will also qualify for a 10 percent increase to the base and bonus credits. An "energy community" includes brownfield sites, certain areas with significant employment related to, or local tax revenues generated by, coal, oil, or natural gas, and where there is high unemployment, or a census tract where a coal mine has recently closed or a coal-fired electric plant was retired or removed.

NEW "TECHNOLOGY NEUTRAL" TAX CREDITS

The IRA added new tax credits that apply to qualified facilities placed into service after December 31, 2024, and which yield zero greenhouse gas emissions. The Section 45Y Clean Electricity Production Credit ("CEPTC") and the Section 48E Clean Electricity Investment Credit ("CEITC") will replace the PTC and ITC, respectively, and are intended to be technology neutral. The credit amounts for the CEPTC and CEITC are calculated similarly to the PTC and ITC and are subject to similar prevailing wage and apprenticeship bonus requirements.

NEW WAYS TO MONETIZE TAX CREDITS UNDER THE IRA

The Act established the following two novel methods to monetize energy tax credits.

Direct Pay Available to Tax Exempt Organizations

For tax years beginning after December 31, 2022, and before January 1, 2033, certain "applicable entities" can make an election to receive a cash payment equal to the value of otherwise allowable tax credits. This option allows for the applicable entities to utilize and monetize the tax credits via a refund, even though the entities generally do not incur tax liabilities. The term "applicable entities" includes tax-exempt organizations, state and local governments, tribal governments, and the Tennessee Valley Authority.

The direct pay option is also available to taxpayers claiming the Sections 45V, 45Q, and 45X credits even if they do not meet the definition of an "applicable entity."

Third-Party Sales

For tax years beginning after December 31, 2022, taxpayers ("transferee") that do not meet the definition of an "applicable entity" may transfer all or a part of their eligible credits to an unrelated taxpayer ("transferor") in exchange for cash. The cash consideration is not includible in the income of the transferor and is not deductible by the transferee. Credits may not be transferred more than once. In the case of any transfer election, the transferee taxpayer will be treated as the taxpayer for all purposes under the IRC with respect to such credit. With respect to a project held by a partnership, only the partnership itself (and not its partners) can elect to transfer the eligible credits. (Emphasis added.) Then it is likely to be treated as unrelated trade or business.

All of the tax credits eligible for the direct pay option, except for the Section 45W Clean Commercial Vehicles Credit, are also eligible for sale to a third-party.

NOTICES 2023-17 AND 2023-18

On February 13, 2023, the IRS issued Notices 2023-17 and 2023-18 which provide guidance on the administration of two allocation-based renewables tax credit programs under Sections 48(e) and 48C, respectively.

Notice 2023-17

The Act amended Section 48(e) to provide an increase in the ITC for qualified solar and wind facilities which are deployed in specified low-income communities or residential developments. To receive these increased credit amounts, a taxpayer must receive an allocation of "environmental justice solar and wind capacity limitation" ("Capacity Limitation"). A "qualified solar and wind facility" is any facility that (1) generates electricity solely from a wind facility, solar energy property, or small wind energy property; (2) has a maximum net output of less than five megawatts (as measured in alternating current); and (3) is described in at least one of the four categories described in the chart below.

Notice 2023-17 established the Low-Income Communities Bonus Credit Program under Section 48(e) and provided guidance on the procedures and information required to apply for an allocation of Capacity Limitation. For each of 2023 and 2024, the annual capacity limitation is 1.8 gigawatts of direct current capacity, which will be allocated among four categories of projects as follows:

Category	Required Facility Location	Capacity Limitation Allocation (MW)	Bonus Percentage
1	Low-Income Community	700 MW	10%
2	Indian Land	200 MW	10%
3	Qualified Low-Income Residential Building Project	200 MW	10%
4	Qualified Low-Income Economic Benefit Project	700 MW	10%

A taxpayer must submit an application to the IRS in order to receive a Capacity Limitation allocation. Details regarding the application process are forthcoming, however, Notice 2023-17 states that applications will be accepted in a phased approach during a 60-day application window for calendar year 2023. Applications will be accepted for Category 3 and 4 projects beginning in the third quarter of 2023, and Category 1 and 2 project applications will be accepted thereafter.

The Department of Energy ("DOE") will review applications for statutory eligibility and any other criteria provided by the IRS. On this basis, the DOE will provide recommendations to the IRS regarding the selection of applicants for an allocation of Capacity Limitation. If the selected applications exceed the capacity limitations for a given category, the DOE will use a lottery system or some other process to allocate Capacity

Limitations. If accepted, the IRS will notify the applicant of its decision and specify the amount of Capacity Limitation allocated. Within four years of receiving such notification applicants must place the eligible property in service to claim the increased credit rate.

Notice 2023-18

The Act extended the Section 48C Advanced Energy Project Credit ("48C Credit" or "AEPC"), which was originally enacted as part of the American Recovery and Reinvestment Act of 2009. Section 48C provides a credit for investments in projects that fall into one of the following three general categories: (i) clean energy manufacturing and recycling projects, (ii) greenhouse gas emission reduction projects, and (iii) critical materials projects. The AEPC is subject to an aggregate cap of $10 billion, at least $4 billion of which will be allocated to census tracts (or tracts adjacent to census tracts) in which coal mines have been closed after 1999 or coal-fired generation facilities have been retired after 2009.

Notice 2023-18 provides guidance on the process and timeline for applying for an allocation of 48C Credits. The first allocation round of $4 billion began on May 31, 2023. Outlined below is an overview of the application, review, and approval process for the first allocation round of 48C credits:

- The applicant submits a "concept paper" to the DOE between May 31, 2023, and July 31, 2023.

- After reviewing the concept paper, the DOE will issue a letter to the applicant either encouraging or discouraging the submission of an application. All applicants that submit a concept paper during the above period may submit an application irrespective of the DOE's response.

- The applicant submits an application to the DOE for review. If the applicant intends to apply for a bonus credit because it will satisfy the prevailing wage and apprenticeship requirements, it must confirm this in the application.

- The DOE then makes a recommendation as to whether to accept or reject the application and provides a ranking of the applications.

- Based on the DOE's recommendations and rankings, the IRS will make a decision regarding the acceptance or rejection of the application and notify the applicant of its decision.

- Within two years after receiving an allocation from the IRS, the applicant must provide evidence to the DOE that the certification requirements have been met.

- The DOE notifies the applicant and the IRS that it has received the applicant's notification that the certification requirements have been met.

- The IRS will provide a letter to the applicant certifying the project ("Allocation Letter").

- Within two years after receiving the Allocation Letter, the applicant must notify the DOE that the project has been placed in service. The applicant may claim the 48C Credit in the year in which the property is placed in service.

Additional guidance from the Treasury Department and IRS is expected to be released throughout the year.

For more information or assistance, contact Michael I. Sanders, Joseph T. Gulant, Andrew M. Logan or another member of Blank Rome's Tax group.

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1. Unless otherwise stated, all "Section" references are to the IRC.
2. For any investment tax credit under Section 50(b)(3), an exempt organization could only avail itself of such credit to the extent the property in question was used in unrelated business income. So in effect, prior to the enactment of IRA, any property that was used consistent with the tax exempt organization's mission presented an obstacle which Section 6417 expressly overrides. Section 50(b)(3).
3. If a taxpayer fails to meet the prevailing wage requirement during a particular year, the taxpayer may cure the failure by paying each worker the difference between actual wages paid and the prevailing wage, plus interest and a penalty of $5,000. If a taxpayer's failure to pay prevailing wages was due to "intentional disregard," then the taxpayer must pay each worker three times the difference and pay the IRS a $10,000 penalty per worker.