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5 Inflation Reduction Act Questions For The Energy Industry

By **Keith Goldberg**

Law360 (January 2, 2023, 12:03 PM EST) -- The Inflation Reduction Act promises to supercharge clean energy development, but attorneys say key questions about the recently enacted law must be answered in order to turn that promise into a reality.

The clean energy industry is eagerly awaiting further guidance from the U.S. Department of the Treasury and Internal Revenue Service about labor and U.S. manufacturing requirements in the IRA that could significantly boost, or reduce, the value of tax credits for a slew of clean energy technologies. The industry also wants more detailed rules on selling tax credits if project developers can't directly use them.

"How the rules shake out will have a big influence [on] which projects move and what the relative risk discounts attached to those projects and their tax investments will be," said Baker Botts LLP partner Elias Hinckley, who works on renewable energy project development and finance. "The faster we have certainty, the easier it is to draw the landscape and reduce some the friction in the transaction process."

Clean energy developers and investors are also eager to find out how the U.S. Department of Energy decides to use the billions of dollars of additional loan authority granted by the IRA, as well as how to capitalize on the environmental justice portions of the law.

Here, attorneys outline some of the biggest unanswered questions for energy companies as the IRA is implemented.

How Will Labor Requirements Be Applied?

The IRA contains two critical labor requirements — providing prevailing wages and employing a certain amount of registered apprentices — that project owners must meet to qualify for the bonus rate of 30% for the investment tax credit or 1.5 cents per kilowatt-hour for the production tax credit. The requirements also apply to other tax incentives, such as the advanced energy project credit and alternative fuel refueling property credit.

In November, the Treasury Department provided some initial guidance on complying with the requirements, including confirming the use of two long-standing methods — known as the physical work and 5% safe harbor tests — to determine the start date of construction on projects. It also started a 60-day clock for developers to comply with the requirements.

But Troutman Pepper tax partner Anne Loomis said developers still have a host of questions for Treasury, including the scope of project construction, modification and repair activities that the prevailing wage and apprenticeship requirements will apply to, and whether they will apply to offsite manufacturing of project components or to repair work once a project is up and running.

"They need to be addressed now while they're getting their contracts in place," Loomis said. "They're very much live issues that the IRS could weigh in on, even if they're not ready to answer all the questions about prevailing wage and apprenticeship."

Hinckley of Baker Botts said that project owners can try to fill in some of those gaps contractually, but they don't have full transparency or control over their engineering, procurement and construction firms or subcontractors.

"There's going to be some friction between owners and tax investors over how can you ensure that prevailing wage requirement will be met by the time they make their investment," Hinckley said.

What Does "Made In The USA" Really Mean?

The IRA also offers significant bonuses for tax credits like the ITC and PTC when developers meet requirements that raw materials and manufactured products used in their projects are made in the U.S. Those items must contain at least 40% of U.S.-made materials — 20% for offshore wind project materials — to qualify for "domestic content" enhancements that could boost the value of the PTC by 10% and the value of the ITC by 33%.

But attorneys say the particulars of the domestic content requirements need a major fleshing-out, including how the 40% U.S.-made test is going to be applied, to what products will be subject to it and how developers must climb up the supply chain.

"If you purchase a [solar] module manufactured and assembled in the U.S., do you have to look to the components of the module to determine domestic content, or do you have the module and that's all you have to do?" Phil Tingle, the global co-head of McDermott Will & Emery LLP's energy and project finance practice, said. "The Treasury Department has a substantive decision to make as to how to determine it."

Morgan Lewis & Bockius LLP partner Levi McAllister, who heads the firm's electric vehicles working group, said the need for domestic content guidance is especially acute for automakers that face state and federal mandates to decarbonize and electrify their vehicle fleets and must establish long-term supply chains. California, for example, has set a 2035 deadline to phase out sales of new gas-powered vehicles.

"They cause manufacturing adjustments to be made now, for automakers to reassemble their assembly lines," McAllister said. "You don't change for the 2035 model year in 2034. You do that now."

The new clean vehicle tax credit enshrined in the IRA also has an enhancement for EV batteries whose raw materials are mined and processed in the U.S. or free-trade allies whose final product is manufactured in North America.

How Can Tax Credits Be Transferred?

If there's a piece of guidance the clean energy industry needs sooner than most, it might be the guidance on the IRA's so-called "transferability" provisions that allow the developers to transfer PTCs and ITCs to others in exchange for cash. Those provisions went into effect at the start of this year.

"The whole purpose of these credits is to effectively subsidize construction," Tingle of McDermott said. "Unless you can monetize the credit, you haven't done anything."

Attorneys say a broad swath of IRS transferability guidance is needed — how it applies to partnerships, especially ones with both taxable and tax-exempt partners; how a buyer's tax burden will be determined based on when they buy the credit; and how the IRS is going to track tax credit transfers in order to prevent any double-counting or fraud.

"That is going to cause some slowdown in the tax credit market until we know what the procedure is going to look like," Loomis of Troutman Pepper said

Attorneys say the bonuses that are available for tax credits like the ITC and PTC make answering transferability questions even more urgent.

"Everybody is going to be pretty keen on how they can implement that one-time ability to transfer ITC and not have to go through the whole tax equity structure, which is time-consuming and very expensive for [project] sponsors," John Crossley, a partner in K&L Gates LLP's power and renewables practice, said.

The IRA contains a direct-pay option for nonprofit entities in lieu of the tax credits. But Debbie Gordon, who leads the Washington excise tax and energy tax practice at tax consulting firm RSM US LLP, said there are key transferability questions associated with that as well. They include whether for-profit companies can allocate tax credits to nonprofit partners that can convert them to direct pay, and whether nonprofits can buy tax credits and convert them to direct pay.

"There are more options now, more scenarios that need to be modeled out," Gordon said. "You know that in theory, there's a credit or a direct pay option. But it's all still a little murky."

How Will The DOE Spend Its Billions?

While most of the focus of IRA implementation is on Treasury and the IRS, the law also gives the DOE a mountain of cash to fund manufacturing, facility construction, and research and development. The agency's Loan Programs Office received $11.7 billion in funding from the law to support issuing new loans, which help boosts the loan authority in its existing loan programs by $100 billion.

The agency also got $5 billion to create a loan program aimed at rehabilitating and greening older energy infrastructure, with a loan authority that could reach $250 billion.

"How are they going to give priorities to those who apply?" Jeffrey Whittle, who heads Womble Bond Dickinson LLP's global energy and natural resources industry group said. "How are those priorities going to be established? It isn't really quite clear how to get access to those funds."

Hogan Lovells projects partner Dave Locascio said that question may only be answered as companies start to go through the loan application process. The DOE has consistently said that it's open to funding any and all projects it deems viable, but Locascio said it remains to be seen how much the massive influx of IRA cash will encourage the agency to broaden its horizons.

"The DOE is historically attracted to new technologies and gives preference to those types of projects," Locascio said. "Will the DOE support old technology that hasn't been done much, or will they save their dollars for truly new technologies?"

How To Cash In On Environmental Justice?

The IRA has a raft of provisions to ensure that environmental justice concerns are addressed in the clean energy development encouraged by the law, such as tax credit bonuses for solar projects in disadvantaged communities and funding for state, local and tribal clean energy development programs.

But unlike tax credits and DOE loans, which have already been around for decades, many of these provisions are being implemented on a blank slate, attorneys say.

One such provision is a tax credit bonus for building projects in "energy communities," which include brownfields, areas with shuttered coal mines, or high-unemployment areas that were historically home to fossil fuel industry jobs. It makes projects a lot more valuable given the amount of potential "energy communities" available, but there's no precise precedent to go on, Loomis of Troutman Pepper said.

"If you have a facility that's going to be partially in an energy community, how much of your facility needs to be in that energy community for the project to qualify for the enhancement?" Loomis said. "Does the whole project qualify, or just the portion that's in the community?"

Industry is also waiting to see how the U.S. Environmental Protection Agency will set up its $27 billion Greenhouse Gas Reduction Fund, a first-ever federal green bank authorized by the IRA that will fund clean energy and greenhouse gas emission-reduction projects, particularly in low-income and disadvantaged communities.

Several state and local green banks exist, but they pale in size to what the EPA is being asked to set up. And while the agency is no stranger to handing out grants and loans, this level of institutionalized financing has traditionally been carried out by agencies such as the DOE, ArentFox Schiff LLP partner Sarah Fitts said.

"A green bank could be so many different things. It could be a lender, an equity holder, subordinated lender, lots of things that commercial lenders won't do," Fitts said. "But the EPA hasn't done this before."

--Additional reporting by Kat Lucero and Linda Chiem. Editing by Gemma Horowitz.

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