

## TREASURY RELEASES A SWATH OF GUIDANCE ON THE INVESTMENT TAX CREDIT

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On November 17, 2023, the U.S. Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) issued proposed regulations regarding the definition of “energy property” and related rules applicable to the energy credit (Proposed Regulations) available under section 48 of the Internal Revenue Code of 1986, as amended. *See* 88 Fed. Reg. 82,188 (Nov. 22, 2023). Additionally, the Proposed Regulations withdrew certain proposed regulations under section 48 that were recently released on the prevailing wage and apprenticeship requirements (Labor Requirements) and have restated them, with changes, in the Proposed Regulations.<sup>1</sup> These Proposed Regulations will almost certainly be subject to some change before being made final.

As background, the Inflation Reduction Act of 2022 (IRA) made significant revisions and expansions to the investment tax credit (ITC) under section 48 for taxable years beginning after December 31, 2022.<sup>2</sup> Generally, eligible taxpayers can claim the ITC for qualifying energy property and may be eligible to claim an increased ITC if the Labor Requirements are satisfied or requirements for certain “bonus” credits are met.

The Proposed Regulations are fairly comprehensive (over 120 pages in length) and provide detailed guidance on a host of topics, issues, and nuances raised in connection with IRC § 48.<sup>3</sup> A fulsome summary of these Proposed Regulations is beyond the scope of this alert, but a few notable items are highlighted below:

- **Types of Energy Property:** Definitions for various classes of energy property are provided (e.g., solar energy property, fiber-optic solar energy property, electrochromic glass property, geothermal energy property, qualified fuel cell property, qualified microturbine property, combined heat and power system property, qualified small wind energy property, geothermal heat pump equipment, waste energy recovery property, and microgrid controllers).
  - **Energy Storage Technology:** The Proposed Regulations adopt a technology-neutral definition for energy storage technology and provide a non-exclusive list of different types of energy storage technologies (i.e., rechargeable electrochemical batteries (lithium ion, vanadium flow, sodium sulfur, and lead-acid), ultracapacitors, physical storage (pumped storage hydropower, compressed air storage, flywheels), and reversible fuel cells). Virtual batteries that shift demand to different points in time would not be considered energy storage technology.
    - Given the expansion of the ITC by the IRA to include stand-alone storage, the preamble to the Proposed Regulations clarifies that there is no minimum amount of electricity that must be stored from a renewable source.

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<sup>1</sup> Our prior coverage of the Labor Requirements can be found [[here](#)].

<sup>2</sup> Our prior coverage of the IRA can be found [[here](#)] and [[here](#)].

<sup>3</sup> The Proposed Regulations note that it does not take into account written comments submitted in response to the proposed regulations issued in June (addressing transfers under section 6418 and direct pay under section 6417) or August (addressing the Labor Requirements).

- Energy storage technology excludes property primarily used in the transportation of goods or individuals (e.g., batteries incorporated into motor vehicles), but the preamble to the Proposed Regulations provides that the exclusion is not intended to apply to batteries and other energy storage property that may be used to recharge such vehicles or modes of transportation if physically separate.
- Hydrogen energy storage property must store at least 0.127 kg of hydrogen or at least 52.7 standard cubic feet of hydrogen and must store such hydrogen solely for use as energy (e.g., storage for production of fertilizer does not qualify). A non-exclusive list of qualifying property is provided (i.e., a hydrogen compressor and associated storage tank, and an underground storage facility and associated compressors).
- **Biogas Property:** Consistent with the statute, the Proposed Regulations provide that qualified biogas property includes functionally interdependent property that is part of a system that cleans or conditions qualified biogas (e.g., waste feedstock collection system, landfill gas collection system, mixing or pumping equipment, anaerobic digester). However, arguably inconsistent with the statute, the Proposed Regulations take the position that qualified biogas property does NOT include any gas upgrading equipment necessary to concentrate the gas into the appropriate mixture for injection into a pipeline through removal of other gases (e.g., carbon dioxide, nitrogen, or oxygen) because, according to the Preamble to the Proposed Regulations, such equipment “is not necessary to satisfy the statutory requirements that the biogas converted from biomass contain not less than 52 percent methane, and that it be captured for sale or productive use.” The Proposed Regulations also provide that the methane content is measured at the point at which gas exits the biogas production system (e.g., at the anaerobic digester, landfill gas collection system, or thermal gasification equipment). Treasury’s position on these issues is likely to frustrate taxpayers and their efforts to develop these systems, and we expect that Treasury will receive significant pushback from stakeholders.
- **Offshore Wind Property:** In an example, the Proposed Regulations provide that energy equipment for a qualified offshore wind facility includes components up to and including the transformer and switchgear housed in the onshore substation (i.e., wind turbines; inter-array cables; the transformer and converter at the offshore substation; subsea export cables; and the converter, transformer, and switchgear at the onshore substation) but, as expected, excludes transmission and distribution equipment. This is undoubtedly welcome clarification and certainty for the offshore wind industry—especially as it relates to the ITC eligibility of subsea export cables.
- **Scope of Energy Property:** The Proposed Regulations provide a definition of ITC eligible energy property that is generally consistent with prior law in that all components of the qualified facility (up to transmission) are generally ITC eligible. Additional clarifications include:

- ***Co-ownership of Energy Property:*** If multiple persons hold ownership shares in an energy property, each person may be eligible for the section 48 credit to the extent of the person's fractional ownership interest.
- ***ITC Eligibility of Shared Property:*** Multiple energy properties (whether owned by one or more taxpayers) may include shared property that may be considered an integral part of each energy property. Such shared property may be ITC eligible in proportion to relative ownership. However, if, for example, power conditioning and transfer equipment that is an integral part of an energy property is owned by a taxpayer unrelated to the owner of the energy property, the owner of the energy property would be eligible for the ITC on such energy property but the owner of the power conditioning and transfer equipment would not be eligible for the ITC on such equipment.
- ***Modifications to Energy Property:*** In general, additions or modifications to existing energy property are not ITC eligible unless the "80/20 Rule" (discussed below) is satisfied.
- ***Intangibles:*** The Proposed Regulations specifically note that energy property does *not* include intangibles (e.g., power purchase agreements, goodwill, going concern value, and RECs). This is clearly consistent with section 48 (which defines qualified property as tangible personal property and certain other tangible property), but, as a general matter for a newly constructed facility, we believe this clarification should have little or no application.
- **Labor Requirements:** The Proposed Regulations implementing the Labor Requirements now provide additional guidance regarding recapture and a few technical corrections.
  - ***Recapture Event:*** Failure to satisfy the prevailing wage requirements with respect to alteration and repair during the five-year period beginning on the date an ITC project is placed in service (the "recapture period") and failing to cure such failure, is a recapture event.
  - ***Recapture Amount:*** The recapture percentage steps down on each anniversary of the project's placed-in-service date by 20%. It will be interesting to see whether there will be future guidance providing a similar concept for projects receiving production tax credits (PTCs).
  - ***Recapture Liability:*** For taxpayers transferring the ITC under section 6418, the Proposed Regulations clarify that the transferee bears the recapture liability.
  - ***Annual Reporting:*** Taxpayers will be required to annually report information on payment of prevailing wages with respect to alterations or repairs to the IRS during the recapture period.
- **Placed in Service:** The Proposed Regulations generally reaffirm the existing placed-in-service rules.
  - ***Adoption of Two-Part Test:*** Energy property is considered placed in service on the earlier of: (i) the taxable year in which depreciation begins or (ii) the taxable year in which the energy property is placed in condition or state of readiness and

availability for a specifically assigned function (typically determined using the “five factor” test).

- Clarification was provided that energy property may be placed in service for U.S. federal income tax purposes even if it is “operational but undergoing testing to eliminate defects.”
- **Original Use:** The Proposed Regulations state that the “original use” must begin with the taxpayer claiming the credit.
- **Units of Property:** Under the Proposed Regulations, a unit of energy property consists of all functionally interdependent components of property (i.e., the placing in service of each component is dependent upon the placing in service of each of the other components in order to perform the intended function). This appears to contemplate treating solar or battery storage blocks or circuits (and similar units of other types of property) as separate units of energy property which may be placed in service on an individual/independent basis.
- **Adoption of the 80/20 Rule:** The Proposed Regulations formally adopt the “80/20 Rule” for energy property.
  - **80/20 Rule for Energy Property:** Under the “80/20 Rule,” retrofitted energy property may qualify as originally placed in service if the used components of the unit of energy property account for not more than 20% of the total value of the unit of energy property, taking into account the cost of the new components of the property plus the value of the used components.
  - **ITC Eligible Costs:** If the 80/20 Rule is satisfied, only the costs “that relate to the new components of the unit of energy property” are ITC eligible.
- **Single Project Rule:** For purposes of the application of the Labor Requirements and bonus credit qualification, an energy project is a project consisting of one or more energy properties that are part of a single project. Notice 2018-59 (providing guidance on the Beginning of Construction rules for ITC projects) included seven factors that indicate that multiple energy properties may be treated as part of a single project, and the Proposed Regulations provide that, for purposes of the single project rule, a taxpayer that owns multiple energy properties only needs to satisfy two of the requirements.
- **Co-Location of ITC and PTC Facilities Permitted:** The Proposed Regulations clarify that a qualified facility receiving a production tax credit under section 45 and an ITC energy project receiving the ITC under section 48 may be co-located without disturbing the respective credit eligibilities of the other facility (for example, an energy storage facility may receive an ITC while a co-located wind or solar facility may elect to claim PTCs).
- **Taxpayer Reliance on Proposed Regulations**
  - **General Rule:** A taxpayer may generally rely on these Proposed Regulations with respect to property placed in service after December 31, 2022, and during a taxable year beginning on or before the date the final regulations are published in

the *Federal Register*, provided that the taxpayer and all related persons apply the Proposed Regulations in their entirety and in a consistent manner.

- ***Labor Requirements:*** A taxpayer may rely on the portion of the Proposed Regulations that relate to the Labor Requirements for projects that begin construction on or after January 29, 2023, and on or before the date these regulations are published as final regulations in the *Federal Register*, provided that, beginning after October 28, 2023, taxpayers follow the portion of the Proposed Regulations that relate to the Labor Requirements in their entirety and in a consistent manner.