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IRS and Treasury Release Update to Notice 2023-29 on "Energy Community" Bonus for ITC- and PTC-eligible Projects

Client Alert | April 12, 2023

On April 4, 2023, the IRS and Treasury issued Notice 2023-29 (the "Notice") (here), which provides eagerly awaited guidance for developers and investors seeking to qualify energy projects for the energy community bonus credit available under sections 45, 45Y, 48, and 48E.[1] Following the passage of the Inflation Reduction Act of 2022 (the "IRA"),[2] each of these sections provides for a "bonus" credit for certain facilities that are located in an "energy community." The Notice includes rules for determining (i) what constitutes an "energy community" and (ii) whether a qualified facility, energy project, or any energy storage technology is "located" or "placed in service" within an energy community. The IRS and Treasury ultimately expect to issue regulations addressing these issues, but, until regulations are proposed, taxpayers may rely on the rules described in the Notice.

On April 7, 2023, Treasury and the IRS made material amendments to the Notice as discussed below.

In connection with the release of the Notice, the Interagency Working Group on Coal and Power Plant Communities and Economic Revitalization also released a searchable mapping tool to help identify areas that may be eligible for the energy community bonus credit. The mapping tool is a general aid and reflects only certain categories of energy communities (and, in the case of Statistical Area energy communities (discussed below), is not yet complete). The mapping tool may not be relied upon by taxpayers.

Background

A bonus credit is available to energy community projects ("EC Projects") under sections 45 and 45Y (the "PTC") and sections 48 and 48E (the "ITC"), each of which is explained briefly below. For PTC projects, the maximum bonus credit available to EC Projects is 10 percent, and for ITC projects, the maximum bonus credit is 10 percentage points.[3]

Under current law, the PTC is claimed in respect of the production of electricity from qualified energy resources (*e.g.*, wind, solar) at a qualified facility during the 10-year period beginning on the date on which the project was placed in service. For zero-emission energy projects that begin construction after 2024, the IRA will transition to a new PTC under section 45Y, which is based on a technology-neutral framework.

The current ITC is claimable in respect of the basis of certain energy property (*e.g.*, wind, solar, and energy storage property). Like the PTC, for zero-emission energy projects that begin construction after 2024, the IRA will transition to a new technology-neutral ITC under section 48E.

Definition of "Energy Community"

The Notice provides clarification and guidance related to three location-based categories of energy communities described in the IRA: (i) the Brownfield Site category, (ii) the

Related People

Josiah Bethards

Emily Risher Brooks

Michael Q. Cannon

Simon Moskovitz

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Statistical Area category, and (iii) the Coal Closure category.

Brownfield Site Category

The Notice defines a Brownfield Site as "real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant" or real property that is "mine-scarred land."[4]

Helpfully, the Notice includes a safe harbor that provides that a site will be a Brownfield Site for purposes of the Notice if that site meets at least one of the following conditions:

1. the site was previously assessed through federal, state, territory, or federally recognized Indian tribal brownfield resources as meeting the definition of a brownfield site under 42 U.S.C. § 9601(39)(A);[5]
2. an ASTM E1903 Phase II Environmental Site Assessment has been completed with respect to the site, and assessment confirms the presence on the site of a hazardous substance, pollutant or contaminant; or
3. for projects with a nameplate capacity of not greater than 5MW (AC), an ASTM E1527 Phase I Environmental Site Assessment has been completed with respect to the site.

However, a site otherwise within one of these prongs is excluded from the safe harbor (and the Brownfield Site category) if it falls within a category of property in 42. U.S.C. § 9601(39)(B) (e.g., such site is already under remediation, on the Superfund National Priorities List, or previously permitted for hazardous waste disposal or treatment).

Statistical Area Category

This category includes a metropolitan statistical area (an "MSA") or a non-MSA that (i) has (or had at any time after December 31, 2009) 0.17 percent or greater direct employment (the "Fossil Fuel Employment Test") or 25 percent or greater local tax revenue (the "Fossil Fuel Tax Revenue Test") related to the extraction, processing, transport, or storage of coal, oil, or natural gas and (ii) has an unemployment rate at or above the national average unemployment rate for the previous year (as determined by the IRS) (the "Unemployment Rate Test").

The Fossil Fuel Employment Test is calculated by dividing (i) the number of people employed in certain industries identified by certain NAICS codes,[6] by (ii) the total number of people employed in that area. The Unemployment Rate Test is calculated by dividing (i) the total number of unemployed individuals within the MSA or non-MSA by (ii) the total labor force in that MSA or non-MSA, as applicable. Annual unemployment rates are generally released in April of the following calendar year. The Notice also provides detailed definitions for MSAs (which the Notice defines by reference to Office of Management and Budget standards that generally are static for 10 years and were last updated in 2018) and non-MSAs.[7]

The Notice does not provide a methodology for calculating the Fossil Fuel Tax Revenue Test and invites comments to address possible data sources, revenue categories, and procedures to determine whether a MSA or non-MSA qualifies through the Fossil Fuel Tax Revenue Test, noting the potential difficulty of applying the test in light of the substantial number of taxing jurisdictions and absence of a centralized information repository.

The Notice includes an appendix listing all MSAs and non-MSA (by county) that satisfy the Fossil Fuel Employment Test (here). The IRS and Treasury intend to issue in May of each year a list identifying the MSAs and non-MSAs that qualify under the Statistical Area category for the twelve-month period starting in that May and continuing through April of the following year.

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Coal Closure Category

This category is defined as a census tract (or a census tract directly adjoining such census tract) in which either (i) a coal mine has closed after December 31, 1999 or (ii) a coal-fired electric generating unit has been retired after December 31, 2009.

The Notice includes an appendix listing all census tracts that are included in the Coal Closure category (here). The Notice makes clear that census tracts are directly adjoining if their boundaries touch at any single point.

A coal mine is treated as having closed if it is a surface or underground mine that has ever had for any period of time, since December 31, 1999, a mine status listed as abandoned or abandoned and sealed (in a list maintained by the Mine Safety and Health Administration).

A coal-fired electric generating unit is treated as having been retired if it has been classified as retired at any time since December 31, 2009 in certain inventories maintained by the U.S. Energy Information Administration and if, at the time of being listed as retired, the generating unit was characterized (under rules set forth in the Notice) as a coal-fired electric generating unit by the U.S. Energy Information Administration. The retirement of a single coal-fired electric generating unit at a plant with multiple units would cause the retired unit's entire census tract to be a Coal Closure category tract.

Closed coal mines and retired coal-fired electric generating units are excluded from this category if they have irregular location information; however, taxpayers may work with the Mine Safety and Health Administration and the U.S. Energy Information Administration to correct irregular location information.

Beginning Construction and Location Requirements for an "Energy Community"

To qualify for the energy community bonus credit, a PTC project must be "located in" an energy community and an ITC project must be "placed in service" within an energy community. For PTC purposes, the general rule is that a qualified facility must be located in an energy community each year that a PTC is claimed in respect of that facility. For ITC purposes, however, the determination of whether a project is placed in service within an energy community generally is required to be made as of the date the project is placed in service.

The rules described in the preceding paragraph (particularly with respect to the PTC, which is claimed over a multi-year period) could present practical difficulties for the development and financing of projects, usually a capital intensive and multi-year process that relies upon the accuracy of forecasted credit availability, in particular for projects in Statistical Area energy communities (for which status is redetermined annually under the Unemployment Rate Test). Fortunately, the Notice provides a taxpayer-friendly rule that, if a project is located in an energy community on the date that construction begins, that location will, in the case of PTC projects, be deemed an energy community for the entire 10-year credit period and, in the case of ITC projects, be deemed an energy community on the date the project is placed in service.

> ***Update***: On Friday, April 7, 2023, Treasury and the IRS amended the Notice to provide that the foregoing taxpayer-friendly rule would apply only to projects that begin construction on or after January 1, 2023.

The determination as to whether construction has begun is made pursuant to well-established guidance (including Notice 2013-29 and its further clarifications and extensions). Nevertheless, there are various practical aspects of the application of this existing guidance to the "energy community" determination that could benefit from further clarification, including the following:

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Given that Notice 2013-29 and its progeny allow for construction to be treated as having begun in a particular year based on off-site physical work of a significant nature or based on incurring a certain percentage of the costs of a project in that year, it would be good to receive confirmation that the relevant year for making these determinations is nonetheless the year when that physical work of a significant nature was done or those expenditures were incurred. In particular, these rules may place further pressure on a particular area of uncertainty that pre-dates the IRA – the extent to which off-site work has been identified and properly associated with a specific project (and location) at the time the off-site work begins.

Moreover, it would be helpful to receive express confirmation whether the continuity requirements under the existing guidance, which generally require a facility to be placed in service within a certain number of years (*i.e.*, after the year when the relevant activities (or spending) that would otherwise satisfy the "begun construction" requirement under the guidance occurred) in order for construction to actually be deemed to have begun in such year, apply for purposes of determining a project's eligibility for the "energy community" begun construction rule.

Finally, given that construction of some projects that potentially qualify for the "energy community" bonus began before publication of the Notice, it would be helpful for the IRS and Treasury to permit taxpayers to apply the begun construction rule using either the year in which construction first began (under Notice 2013-29 and subsequent guidance) or the first taxable year ending after the date of the Notice in which additional physical work is completed (or additional costs are incurred) that independently would satisfy the requirements of Notice 2013-29 and subsequent guidance.

Update: On Friday, April 7, 2023, Treasury and the IRS amended the Notice to provide that the Notice's special beginning-of-construction rule would apply only to projects that begin construction on or after January 1, 2023. Limiting application of this special rule to projects that begin construction after 2022 is unusually restrictive and may require taxpayers to attempt to "re-commence" construction in energy communities where construction may have already properly begun in order to benefit from the certainty provided by the begun construction rule. Moreover, it seems particularly inequitable to discriminate against projects that began construction in 2022 on or after the date President Biden signed the IRA into law (*i.e.*, August 16, 2022).

In addition to rules specifying when the "energy community" determination is made, the Notice explains which portion of the project needs to be within an "energy community." A project with "nameplate capacity" is, in general, treated as located in or placed in service within an energy community if 50 percent or more of the project's nameplate capacity is in an area that qualifies as an energy community. If a project does not have a nameplate capacity, then that project is, in general, treated as located in or placed in service within an energy community if 50 percent or more of the project's square footage is in an energy community.

However, the Notice also provides a special taxpayer-friendly rule for offshore energy facilities (such as offshore wind farms) that have nameplate capacity but no energy-generating units located in a census tract, an MSA, or non-MSA (which is likely). For these facilities, the entire nameplate capacity of the facility is attributed to the land-based equipment that conditions energy generated by the facility for transmission, distribution, and use. Effectively, this rule provides that taxpayers can gain access to the energy community bonus credit for an offshore facility by locating the power conditioning equipment for that facility in an onshore energy community. Importantly, and what appears to be a trap for the unwary, this guidance takes into account only the power conditioning equipment (*e.g.*, a substation) that is closest to the point of interconnection when testing whether an offshore facility is located in an energy community. Accordingly, if an offshore facility has power conditioning equipment in multiple locations, and if the power

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conditioning equipment that is closest to the point of interconnection is not located in an energy community, then the offshore facility would not qualify for the energy community bonus credit (even if other power conditioning equipment is located in an energy community). Developers of offshore wind projects will want to be mindful of these rules when determining the location of power-conditioning equipment.[8]

Effective Date

Taxpayers may rely on the rules set forth in Notice 2023-29 until the issuance of the proposed regulations. The proposed regulations are expected to apply to taxable years ending after April 4, 2023.

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[1] All section references are to the Internal Revenue Code of 1986, as amended.

[2] As was the case with the so-called Tax Cuts and Jobs Act, the Senate's reconciliation rules prevented Senators from changing the Act's name, and the formal name of the so-called Inflation Reduction Act is actually "An Act to provide for reconciliation pursuant to title II of S. Con. Res. 14."

[3] Like the base PTC and ITC themselves, the bonus credit also is reduced by 80 percent for certain projects that do not meet prevailing wage or apprenticeship requirements.

[4] The terms are defined by reference to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. § 9601(39)).

[5] Potential site lists may be found under the category of Brownfields Properties on the EPA's Cleanups in My Community webpage or on similar webpages maintained by states, territories, or for federally recognized Indian tribes. *See* https://java.epa.gov/acrespub/stvrp/.

[6] These codes are the 2017 North American Industry Classification System codes 211 (Oil and Gas Extraction), 2121 (Coal Mining), 213111 (Drilling Oil and Gas Wells), 213112 (Support Activities for Oil and Gas Operations), 213113 (Support Activities for Coal Mining), 32411 (Petroleum Refineries), 4861 (Pipeline Transportation of Crude Oil), and 4862 (Pipeline Transportation of Natural Gas), each as listed in the annual County Files of the County Business Patterns published by the Census Bureau.

[7] The Notice includes an appendix listing all relevant MSAs and non-MSAs (here) that are used for all purposes of the Notice.

[8] It also would be helpful for the IRS and Treasury to confirm that the relevant measurement date for purposes of determining whether power conditioning equipment is located in an energy community is the date on which construction on the corresponding offshore facility began (and not the date on which construction on the power conditioning equipment began).

This alert was prepared by Josiah Bethards, Emily Brooks, Mike Cannon, Matt Donnelly, and Simon Moskovitz.

Gibson Dunn lawyers are available to assist in addressing any questions you may have about these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Tax or Power and Renewables practice groups, or the following authors:

Tax Group: Michael Q. Cannon – Dallas (+1 214-698-3232, mcannon@gibsondunn.com) Matt Donnelly – Washington, D.C. (+1 202-887-3567, mjdonnelly@gibsondunn.com) Josiah Bethards – Dallas (+1 214-698-3354, jbethards@gibsondunn.com) Emily Risher

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Brooks – Dallas (+1 214-698-3104, ebrooks@gibsondunn.com) Simon Moskovitz - Washington, D.C. (+1 202-777-9532 , smoskovitz@gibsondunn.com)

Power and Renewables Group: Peter J. Hanlon – New York (+1 212-351-2425, phanlon@gibsondunn.com) Nicholas H. Politan, Jr. – New York (+1 212-351-2616, npolitan@gibsondunn.com)

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