January 20, 2024

How State and Local Governments Can Use Direct Pay to Transition Toward a Clean Energy Economy

Ground Rules: Disclaimer

- This deck provides an overview of certain Inflation Reduction Act tax provisions for general informational purposes only and **is not itself tax guidance**.
- The content in this presentation is based on proposed and temporary regulations and other tax guidance on IRS.gov.
- This deck relies on simplifications and generalizations to convey high-level points about Inflation Reduction Act tax provisions. Please **refer to guidance** issued by the IRS for detailed information on the rules associated with Inflation Reduction Act tax provisions.

Ground Rules: Questions and Comments

- The **public comment period on provisions related to elective pay (often and herein called <u>direct pay</u>) ended on August 14th**. Please visit regulations.gov to view public comments.
- We will **not be able to provide substantive information** beyond what is in the proposed and temporary rules themselves.
- Given that the proposed regulations are still under consideration, we will **not be able to comment** on opinions, interpretations, or specific-taxpayer related questions. You may also choose to consult with a tax advisor.

Ground Rules: What We Can Discuss

- Provide an overview of the Inflation Reduction Act, the role of the Department of the Treasury in its implementation and the role of state and local governments.
- Offer suggestions on how state and local government should consider opportunities under the Inflation Reduction Act – including the use of direct pay.
- Address concerns and questions related to the Inflation Reduction Act generally and direct pay outside of open policy questions raised in the proposed guidance.
- Discuss the operational process for filing for tax credits under the direct pay provisions.

Introduction: The Inflation Reduction Act

- The Inflation Reduction Act (IRA) makes the **largest investment in clean energy** in United States history. The bulk of the IRA investments flow through the tax code instead of direct government spending.
- The clean energy provisions of the IRA are boosting the U.S. economy. Under the Biden-Harris Administration, as of mid-November 2023, private companies have announced commitments to invest $142 billion in electric vehicle and battery manufacturing, $71 billion in clean energy manufacturing and $133 billion in clean energy projects.
- The IRA is creating jobs, saving consumers money and accelerating the nation's transition to clean energy. It will reduce volatility in the cost of energy and increase the nation's energy independence.

The Role of the Treasury Department

- The Treasury Department is the federal agency responsible for **administering the tax code** and is **proud to be playing a central role** in implementing the Inflation Reduction Act's clean energy tax incentives.
- Treasury's Clean Energy Implementation Activities include:
  - Quickly **developing and issuing tax guidance** to provide clarity and certainty around how the law's tax incentives will operate in practice
  - Working with the Internal Revenue Service to put in place **modern, streamlined processes** for taxpayers to claim the clean energy incentives
  - Conducting **stakeholder engagement and outreach** to inform our approach and to educate the public about the benefits that are now available

The Role of State and Local Government

- Under President Biden’s Executive Order, one of the priorities for Implementation of the Energy and Infrastructure Provisions of IRA is to “**Ensure effective coordination with state, local, Tribal, and territorial governments and other critical stakeholders.**”
- State and local governments will lead in implementation while the primary role of the Federal government is to fund investments.

The Role of State and Local Government

- Potential roles for state and local governments include:
  - A direct role by **incorporating clean energy projects** into their capital planning process and **shifting energy consumption** to clean and renewable sources by changing their fleet to clean vehicles, as just one example
  - **Centering community and economic development** strategies around the clean energy transition
  - **Promoting** consumer and business transition to clean energy

The Role of State and Local Government

- In thinking about how best to take full advantage of the opportunities under the IRA and to lead on the clean energy transition, state and local governments might consider developing a plan of action to:
  - Build a team and establish a process to plan for, obtain funding/financing for and implement critical investments
  - Focus on collaboration across the public, non-profit and civic sectors.
  - Clearly define roles to ensure coordination across your team and among your partners
  - Think about how best to target your efforts to address issues of equity
  - Make sure that you fully understand – and are prepared to execute on – responsibilities and obligations

What is Direct Pay?

- Under the direct pay provisions of the IRA, tax-exempt and governmental entities that do not owe Federal income taxes will, for the first time, be able to receive a **payment equal to the full value of tax credits for building qualifying clean energy projects or making qualifying investments**.
- Unlike competitive grant and loan programs, in which applicants may not receive an award, direct pay allows entities to get their payment if they meet **the requirements for both direct pay and the underlying tax credit**.
- The entities eligible for direct pay (applicable entities) would not normally owe federal income tax. However, by **filing a return and using direct pay**, these entities can receive **tax-free cash payments** from the IRS for clean energy tax credits earned, so long as **all requirements** are met, including a pre-filing registration requirement.

What is Direct Pay?

- **Direct pay is a force multiplier when it comes to investments in the clean energy transition.**
- The direct pay amount varies based on the tax credit being claimed and the specific features of the project, but it can be significant.
- Grants and loans can be used in conjunction with direct pay on specific projects.
- Direct pay **does** require clear project planning and compliance, but it **does not** require state and local governments to compete for a limited pool of competitive grant dollars.

How does Direct Pay work?

Under the proposed rules, applicable entities for elective pay would include:

- Tax-exempt organizations under § 501(a), including § 501(c) and § 501(d) organizations,
- States and political subdivisions such as local governments,
- Indian tribal governments,
- U.S. territory governments and political subdivisions,
- Agencies and instrumentalities of state, local, tribal, and territorial governments – including public utilities, school districts, public hospitals and public higher education
- Alaska Native Corporations,
- The Tennessee Valley Authority, and
- Rural electric co-operatives.

In general, only these applicable entities can use elective pay. However, other taxpayers that are not "applicable entities" may elect to be treated as applicable entities with respect to three credits (for carbon oxide sequestration, production of clean hydrogen, advanced manufacturing production).

How does Direct Pay work?

- Under the proposed rules and regulations, direct pay is applicable to 12 different tax credits related to **energy generation and carbon capture, manufacturing, vehicles and fuels.**

- The value of the credit depends on (a) statutory provisions related to the credit itself and (b) the applicability of various bonus provisions. By and large, the bonus provisions are designed to incentivize the creation of good paying, "high road" jobs and location of investments in low income and energy communities.

- In thinking about how to structure and finance specific projects, it is very important to fully understand the requirements of the bonus provisions.

Applicable Tax Credits for Direct Pay

Energy Generation & Carbon Capture

Tax Provision	Description
Production Tax Credit for Electricity from Renewables (§ 45, pre-2025)	**For production of electricity from eligible renewable sources**, including wind, biomass, geothermal, solar, small irrigation, landfill and trash, hydropower, marine and hydrokinetic energy. **Credit Amount (for 2022):** 0.55 cents/kilowatt (kW); (1/2 rate for electricity produced from open loop biomass, landfill gas, and trash); 2.75 cents/kW if Prevailing Wage and Apprenticeship (PWA) rules are met [1,2,3,7]
Clean Electricity Production Tax Credit (§ 45Y, 2025 onwards)	**Technology-neutral tax credit for production of clean electricity**. Replaces § 45 for facilities that begin construction and are placed in service after 2024. **Credit Amount:** Starts in 2025, consistent with credit amounts under section 45 [1,2,3,6,7]
Investment Tax Credit for Energy Property (§ 48, pre-2025)	**For investment in renewable energy projects** including fuel cell, solar, geothermal, small wind, energy storage, biogas, microgrid controllers, and combined heat and power properties **Credit Amount:** 6% of qualified investment (basis); 30% if PWA requirements met [1,4,5,6,8]
Clean Electricity Investment Tax Credit (§ 48E, 2025 onwards)	**Technology-neutral tax credit for investment in facilities that generate clean electricity** and qualified energy storage technologies. Replaces § 48 for facilities that begin construction and are placed in service after 2024 **Credit Amount:** 6% of qualified investment (basis); 30% if PWA requirements met [1,4,5,6]
Low-Income Communities Bonus Credit (§ 48(e), 48E(h)) **Application required**	**Additional investment tax credit for small-scale solar and wind (§ 48(e)) or clean electricity (§48E(h)) facilities** (<5MW net output) on Indian land, federally subsidized housing, in low-income communities, and benefit low-income households. Allocated through an application process. **Credit Amount:** 10 or 20 percentage point increase on base investment tax credit [7]
Credit for Carbon Oxide Sequestration (§ 45Q)	**Credit for carbon dioxide sequestration** coupled with permitted end uses in the United States. **Credit Amount:** $12-36 per metric ton of qualified carbon oxide captured and sequestered, used as a tertiary injectant, or used, depending on the specified end use; $60-$180 per metric ton if PWA requirements met.[1,7]
Zero-Emission Nuclear Power Production Credit (§ 45U)	**For electricity from nuclear power facilities.** Facilities in operation prior to August 16, 2022. **Credit Amount (for 2023):** 0.3 cents/kWh (reduced rate for larger facilities); 1.5 cent/kWh if PW req's met [1,7]

* For footnotes, see irs.gov/pub/irs-pdf/p5817g.pdf. You can also learn more at IRS.gov/CleanEnergy and IRS.gov/ElectivePay.

Applicable Tax Credits for Direct Pay

	Tax Provision	Description
Manufacturing	**Advanced Energy Project Credit** (§ 48C) Application required	**For investments in advanced energy projects.** A total of $10 billion will be allocated, not less than $4 billion of which will be allocated to projects in certain energy communities. **Credit Amount:** 6% of taxpayer's qualified investment; 30% if PWA requirements are met [1]
Manufacturing	**Advanced Manufacturing Production Credit** (§ 45X)	**Production tax credit for domestic clean energy manufacturing** of components including solar and wind energy, inverters, battery components, and critical materials. **Credit Amount:** Varies by component
Vehicles	**Credit for Qualified Commercial Clean Vehicles** (§ 45W)	**For purchasers of commercial clean vehicles.** Qualifying vehicles include passenger vehicles, buses, ambulances, and certain other vehicles for use on public streets, roads, and highways. **Credit Amount:** Up to $40,000 (max $7,500 for vehicles <14,000 lbs) [9]
Vehicles	**Alternative Fuel Vehicle Refueling Property Credit** (§ 30C)	**For alternative fuel vehicle refueling and charging property**, located in low-income and non-urban areas. Qualified fuels include electricity, ethanol, natural gas, hydrogen, and biodiesel. **Credit Amount:** 6% of basis for businesses and can increase to 30% if PWA is met.
Fuels	**Clean Hydrogen Production Tax Credit** (§ 45V)	**For producing clean hydrogen** at a qualified, U.S.-based clean hydrogen production facility. **Credit Amount:** $0.60/kg multiplied by the applicable percentage (20% to 100%, depending on lifecycle green-house gas emissions), amount increases if PWA is met [1,7]
Fuels	**Clean Fuel Production Credit** (§ 45Z, 2025 onwards)	**Technology neutral tax credit for domestic production of clean transportation fuels**, including sustainable aviation fuels, beginning in 2025* **Credit Amount:** $0.20/gallon ($0.35/gal for aviation fuel) multiplied by CO2 "emissions factor"; $1.00/gallon ($1.75/gal for aviation fuel) multiplied by CO2 "emissions factor" if PWA is met [1,7]

* For footnotes, see irs.gov/pub/irs-pdf/p5817g.pdf. You can also learn more at IRS.gov/CleanEnergy and IRS.gov/ElectivePay.

Certain requirements and bonuses that may affect the amount of Direct Pay applicable tax credits

Prevailing Wage and Apprenticeship Requirements	For a number of the tax credits created or modified by IRA, **the credit amount is increased by five times for projects that meet requirements for paying prevailing wages and using registered apprentices**.
Domestic Content Bonus	Projects or facilities that meet domestic content requirements are eligible for a **10 percent increase** to the Production Tax Credit (sections 45, 45Y) or up to a 10 percentage point increase to the Investment Tax Credit (48, 48E). For projects or facilities beginning construction starting in 2024, for taxpayers using elective pay, the domestic content requirement can also result in a reduction of the Production Tax Credit or Investment Tax Credit if it is not met.
Energy Communities Bonus	Projects located in historical energy communities, including areas with closed coal mines or coal-fired power plants, are eligible for a 10 percent increase in the PTC and an up to **10 percentage point increase** in the ITC. The bonus is also available to brownfield sites and to areas that have significant employment or local tax revenues from fossil fuels and higher than average unemployment.
Low Income Communities Bonus Credit Program	The program provides an increased credit **of 10 percentage points or 20 percentage points to certain applicable credits** that are part of the investment tax credit for certain facilities located in low-income communities, Indian lands, or federal housing projects, or serving low-income households. You must apply and receive a capacity allocation, and then place your facility in service to claim this bonus.

Direct Pay Potential Use Cases

Goal	Project	Relevant Tax Credits
Fleet Cost Savings	Replace existing municipal vehicle fleet with new electric vehicles and associated charging infrastructure	• Up to $7,500 per light vehicle • Up to $40,000 per larger vehicle • Up to 30% credit on investment in eligible EV charging equipment
Community Resilience	Install microgrid with solar and energy storage to serve critical infrastructure and community facilities during emergencies and grid outages	• 6% - 50% credit on investment in solar, storage and microgrid controllers
Community Heating	Develop central geothermal system to provide heating to community buildings and residential households	• 6% - 50% credit on investment in geothermal energy property

How Direct Pay Investments Can Potentially Reduce Cost

Municipal Fleet Electrification	• Estimated **$80 million savings over ten years** from electrification of fleet vehicles for ten largest municipalities in Arizona.
Solar Microgrid	• **50% savings in annual electricity bills**, plus resilience benefits for solar, storage, and microgrid system installed at Chemehuevi Indian Tribe community center in Havasu Lake, CA
Central Geothermal Heating	• Estimated **annual savings of over $2 million** for Ball State University central geothermal heat pump replacement of aging coal boilers heating system for college campus.

How do I claim and receive a direct payment?

- Identify and pursue the qualifying project or activity. You will need to know what applicable credit you intend to earn and use direct pay for.
- Complete your project and place it into service.
- Determine your tax year, if not already known, to determine when your tax return will be due.
- Complete pre-filing registration with the IRS.
  - This will include the credit(s) you intend to earn, among other information.
  - Upon completing this process, the IRS will provide you with a registration number for each applicable credit property.
- File your tax return by the due date (or extended due date) and make a valid elective pay election.
  - Provide your registration number on your tax return as part of making the elective pay election.
  - A valid election allows you to receive payment as a refund for the amount of the credit (or if applicable, offset your tax liability and receive a payment for any remaining amount).
- Receive payment after the return is processed.

IRS Resources

IRS.gov/ElectivePay

Applicable Tax Credits

Clean Energy Tax Incentives: Elective Pay Eligible Tax Credits

The Inflation Reduction Act of 2022 ("IRA") makes several clean energy tax credits available to businesses; tax-exempt organizations; state, local, and tribal governments; other entities; and individuals. The IRA also enables entities to take advantage of certain clean energy tax credits through its elective pay provision (also colloquially known as direct pay). Elective pay allows several types of entities, such as tax-exempts and governments, to treat the amount of certain credits as a payment against tax on their tax returns and as a result receive direct payments for certain clean energy tax credits.

	Tax Provision	Description
Energy Generation & Carbon Capture	**Production Tax Credit for Electricity from Renewables** (§ 45, pre-2025)	**For production of electricity from eligible renewable sources**, including wind, biomass, geothermal, solar, small irrigation, landfill and trash, hydropower, marine and hydrokinetic energy. **Credit Amount (for 2022):** 0.55 cents/kilowatt (kW); (1/2 rate for electricity produced from open loop biomass, landfill gas, and trash); 2.75 cents/kW if Prevailing Wage and Apprenticeship (PWA) rules are met [1,2,3,7]
	Clean Electricity Production Tax Credit (§ 45Y, 2025 onwards)	**Technology-neutral tax credit for production of clean electricity**. Replaces § 45 for facilities that begin construction and are placed in service after 2024. **Credit Amount:** Starts in 2025, consistent with credit amounts under section 45 [1,2,3,6,7]
	Investment Tax Credit for Energy Property (§ 48, pre-2025)	**For investment in renewable energy projects** including fuel cell, solar, geothermal, small wind, energy storage, biogas, microgrid controllers, and combined heat and power properties **Credit Amount:** 6% of qualified investment (basis); 30% if PWA requirements met [1,4,5,6,8]
	Clean Electricity Investment Tax Credit (§ 48E, 2025 onwards)	**Technology-neutral tax credit for investment in facilities that generate clean electricity** and qualified energy storage technologies. Replaces § 48 for facilities that begin construction and are placed in service after 2024 **Credit Amount:** 6% of qualified investment (basis); 30% if PWA requirements met [1,4,5,6]
	Low-Income Communities Bonus Credit (§ 48(e), 48E(h)) Application required	**Additional investment tax credit for small-scale solar and wind (§ 48(e)) or clean electricity (§48E(h)) facilities** (<5MW net output) on Indian land, federally subsidized housing, in low-income communities, and benefit low-income households. Allocated through an application process. **Credit Amount:** 10 or 20 percentage point increase on base investment tax credit [7]
	Credit for Carbon Oxide Sequestration (§ 45Q)	**Credit for carbon dioxide sequestration** coupled with permitted end uses in the United States. **Credit Amount:** \$12-36 per metric ton of qualified carbon oxide captured and sequestered, used as a tertiary injectant, or used, depending on the specified end use; \$60-\$180 per metric ton if PWA requirements met.[1,7]
	Zero-Emission Nuclear Power Production Credit (§ 45U)	**For electricity from nuclear power facilities.** Facilities in operation prior to August 16, 2022. **Credit Amount (for 2023):** 0.3 cents/kWh (reduced rate for larger facilities); 1.5 cent/kWh if PW req's met [1,7]
Manufacturing	**Advanced Energy Project Credit** (§ 48C) Application required	**For investments in advanced energy projects.** A total of \$10 billion will be allocated, not less than \$4 billion of which will be allocated to projects in certain energy communities. **Credit Amount:** 6% of taxpayer's qualified investment; 30% if PWA requirements are met [1]
	Advanced Manufacturing Production Credit (§ 45X)	**Production tax credit for domestic clean energy manufacturing** of components including solar and wind energy, inverters, battery components, and critical materials. **Credit Amount:** Varies by component
Vehicles	**Credit for Qualified Commercial Clean Vehicles** (§ 45W)	**For purchasers of commercial clean vehicles**. Qualifying vehicles include passenger vehicles, buses, ambulances, and certain other vehicles for use on public streets, roads, and highways. **Credit Amount:** Up to \$40,000 (max \$7,500 for vehicles <14,000 lbs) [8]
	Alternative Fuel Vehicle Refueling Property Credit (§ 30C)	**For alternative fuel vehicle refueling and charging property**, located in low-income and non-urban areas. Qualified fuels include electricity, ethanol, natural gas, hydrogen, and biodiesel. **Credit Amount:** 6% of basis for businesses and can increase to 30% if PWA is met.
Fuels	**Clean Hydrogen Production Tax Credit** (§ 45V)	**For producing clean hydrogen** at a qualified, U.S.-based clean hydrogen production facility. **Credit Amount:** \$0.60/kg multiplied by the applicable percentage (20% to 100%, depending on lifecycle greenhouse gas emissions), amount increases if PWA is met [1,7]
	Clean Fuel Production Credit (§ 45Z, 2025 onwards)	**Technology neutral tax credit for domestic production of clean transportation fuels**, including sustainable aviation fuels, beginning in 2025* **Credit Amount:** \$0.20/gallon (\$0.35/gal for aviation fuel) multiplied by CO_2 "emissions factor"; \$1.00/gallon (\$1.75/gal for aviation fuel) multiplied by CO_2 "emissions factor" if PWA is met [1,7]

Please see the notes on the next page or see IRS.gov/cleanenergy for more information.

Frequently asked Questions:

Q15. Are there requirements or bonuses that affect the amount of the applicable credits that are eligible for elective pay? (added June 14, 2023)

Q26. At what stage of development, construction, or operations are projects eligible for elective pay? (added June 14, 2023)

Closing

- More Information on Direct Pay
  - ✔ IRS.gov/ElectivePay
  - ✔ CleanEnergy.gov/DirectPay
- More information on the IRA More Generally
  - ✔ IRS.gov/CleanEnergy
  - ✔ www.whitehouse.gov/cleanenergy/inflation-reduction-act-guidebook/