June 2023

Inflation Reduction Act Elective Pay

Agenda

- Ground Rules and Disclaimers
- Introduction
- Section 6417: Elective Pay

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.

- Treasury and the IRS will **carefully consider feedback submitted** during the public comment periods for proposed and temporarily regulations before issuing final rules.

Ground Rules: Questions and Comments

- The **public comment period is for 60 days**, until **August 14th**. We request that any comments be submitted in writing. Please visit regulations.gov to file and 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.
- We will **carefully consider public feedback** before decisions are made on the substance of final rules.

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Introduction: The Inflation Reduction Act

- The Inflation Reduction Act (IRA) makes the **largest investment in clean energy** in United States history, and much of that investment is **delivered via tax incentives**.
- 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.
- The Inflation Reduction Act includes **tax incentives for a broad range of activities that support building a clean energy economy**, as well as **certain cross-cutting provisions and bonuses** that apply to multiple incentives.
- This presentation discusses **Elective Pay**, a novel tax credit delivery mechanism created by the Inflation Reduction Act.

Treasury's IRA Clean Energy Implementation Activities

1 Quickly **developing and issuing tax guidance** to provide clarity and certainty around how the law's tax incentives will operate in practice

2 Working with the Internal Revenue Service to put in place **modern, streamlined processes** for taxpayers to claim the clean energy incentives

3 Conducting **stakeholder engagement and outreach** to inform our approach and to educate the public about the benefits that are now available

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The Significance of Elective Pay

“The Inflation Reduction Act’s new tools to access clean energy tax credits are a catalyst for meeting President Biden’s historic economic and climate goals. They will act as a force multiplier, bringing governments and nonprofits to the table.”

“More clean energy projects will be built quickly and affordably, and more communities will benefit from the growth of the clean energy economy.”

– Janet L. Yellen, Secretary of the Treasury

Overview of Elective Pay

- With “**elective pay**” (often informally called “direct pay”), 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, elective pay allows entities to get their payment if they meet **the requirements for both elective pay and the underlying tax credit**.
- The entities eligible for elective pay (applicable entities) would not normally owe federal income tax. However, by **filing a return and using elective 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.
- Applicable entities can use elective pay for **12 of the Inflation Reduction Act’s tax credits**.

Applicable Entities

<u>Under the proposed rules, applicable entities for elective pay would include</u>:

- 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,
- Alaska Native Corporations,
- The Tennessee Valley Authority, and
- Rural electric co-operatives.

In general, only "applicable entities" are eligible for Elective Pay. However, other taxpayers that are not "applicable entities" may elect to be treated as an applicable entity with respect to three tax credits (for carbon oxide sequestration, production of clean hydrogen, or advanced manufacturing).

Applicable Tax Credits for Elective 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 Elective 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 greenhouse 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 elective 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.

How do I claim and receive an elective payment?

- Identify and pursue the qualifying project or activity. You will need to know what applicable credit you intend to earn and use elective 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.
  - More information about pre-filing registration will be available by late 2023.
- 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.

Example Timeline: Local Government Project Placed Into Service in 2023

A local government that makes a clean energy investment that qualifies for the investment tax credit can file an annual tax return (via Form 990-T) with the IRS to claim elective pay for the full value of the investment tax credit, as long as it meets all of the requirements, including a pre-filing registration requirement.

As the local government would not owe other federal income tax, the IRS would then make a refund payment in the amount of the credit to the local government.

In 2023	Clean energy project goes into service
Late 2023 or early 2024, before tax return is due	Complete pre-filing registration with the IRS
By May 15, 2024 (for example)	Deadline to file tax return (if you don’t take an extension)
After return is processed	Receive payment

Special Rule: Grants and Loans

- The proposed guidance also includes a special rule that would enable entities to **combine grants and forgivable loans with tax credits**.
- If an investment-related credit property is funded by a tax-free grant or forgivable loan, entities would get the same value of eligible tax credit as if the investment were financed with taxable funds—provided the credit plus ‘restricted tax-exempt amounts’ do not exceed the cost of the investment.
- <u>For example</u>:
    - ➢ A school district receives a tax-exempt grant in the amount of $300,000 to purchase an electric school bus. Under IRA, clean commercial vehicles are eligible for a tax credit of up to $40,000.
    - ➢ The school district purchases the bus for $400,000, using the grant and $100,000 of the school district’s unrestricted funds.
    - ➢ The school district’s basis in the electric bus is $400,000 and the school district’s section 45W credit is $40,000.
    - ➢ Since the amount of the restricted tax-exempt grant plus the amount of the section 45W credit ($340,000) is less than the cost of the electric bus, the school district’s 45W credit is not reduced.

Closing

More Information

- IRS.gov/CleanEnergy
- IRS.gov/ElectivePay
- CleanEnergy.gov/DirectPay
- We will have additional webinars and opportunities for stakeholder education.

Public Comment Period

- The public comment period is for 60 days, until August 14th.
- We request that any comments be submitted in writing. Please visit regulations.gov to file and view public comments.