August 2023

Inflation Reduction Act Elective Pay

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.

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

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 and their subdivisions,
- 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 Tribal Entities

Indian Tribal Governments. The proposed regulations include as applicable entities:

- An **Indian tribal government** (defined as the recognized governing body of any Indian or Alaska Native tribe, band, nation, pueblo, village, community, component band, or component reservation, individually identified (including parenthetically) in the most recent list published by the Department of the Interior in the Federal Register pursuant to section 104 of the Federally Recognized Indian Tribe List Act of 1994 (25 U.S.C. 5131).)
- A **subdivision** thereof
- An **agency** or **instrumentality** of any Indian tribal government or subdivision thereof.

ANCs. The proposed regulations include as applicable entities, consistent with the statute, **any Alaska Native Corporation** (as defined in section 3 of the Alaska Native Claims Settlement Act, 43 U.S.C. 1602(m)).

Native Hawaiian Organizations. The proposed regulations provide that any organization **exempt from the tax imposed by subtitle A by reason of section 501(a) of the Code** is an applicable entity.

- If not already described in 501(c)(3), an organization can seek recognition of this status by filing a Form 1023 or 1023-EZ with the IRS.

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]
	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]
	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]
	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]

* 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: Tribal Government Project Placed Into Service in 2023

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

In 2023	Late 2023 or early 2024, before tax return is due	By May 15, 2024 and up to November 15, 2024	After return is processed
Clean energy project goes into service	Complete pre-filing registration with the IRS	File Form 990-T (between the due date to file the return and the 6-month extended due date the NPRM would automatically allow for that return)	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.
- For example:
  - ➢ 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.

§ 48(e): Low-Income Communities Bonus Credit Program

- § 48(e) can provide a bonus of **10 or 20 percentage points** to qualified solar and wind facilities (less than 5 MW), depending on the **category of facility**, on top of the existing 30% Investment Tax Credit:
    - **<u>Category 1</u>**: Located in a Low-Income Community *(10 percentage points)*
    - **<u>Category 2</u>**: Located on Indian land *(10 percentage points)*
    - **<u>Category 3</u>**: Part of a qualified low-income residential building project *(20 percentage points)*
    - **<u>Category 4</u>**: Part of a qualified low-income economic benefit project *(20 percentage points)*
- To be eligible, property must be **placed in service within four years** after the date the applicant was awarded and notified of the allocation of Capacity Limitation for the facility

Tribal Highlights of Final 48 (e) Regulations and Revenue Procedure

- **Additional Selection Criteria:**
  - Applies to Indian Tribes and their political subdivisions and instrumentalities
  - Tribal Enterprises
  - Alaska Native Corporations
- **Category 2 – Located on Indian Land**
  - Tribal approval included as attestation requirement
  - 200 MW Set Aside
- **Category 3 – Qualified Low-Income Residential Building Project**
  - Covered housing programs and policies:
    - Housing programs administered by an Indian Tribe or a Tribally designated housing entity (as defined in section 4(22) of the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4103(22)).

Application Process Overview

Login.gov
Applicant registers for Login.gov to access Applicant Portal

Applicant Registration
Applicant completes portal registration including organization details

Application for Allocation
Applicant applies for an allocation of Capacity Limitation by providing facility details and required documentation

DOE Review
DOE Review Team conducts initial review of application, requests additional information, if applicable, and provides recommendation to IRS

IRS Review and Determination
IRS reviews recommendation and makes allocation determination

Placed In Service Requirements

Once the facility that has received an allocation has been placed in service, Applicant completes the Placed in-Service step of the process.

DOE Review

DOE Review Team conducts initial review, requests additional information, if applicable, and provides eligibility recommendation to IRS

IRS Review and Determination

IRS reviews recommendation and makes eligibility determination.

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 was for 60 days, and ended August 14th.
- Please visit regulations.gov to view public comments.