Direct Pay and IRS Energy Credits Online

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 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.

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 <u>can</u> be used in conjunction with direct pay on specific projects.
- Direct pay **does** require clear project planning and compliance, but it **does not** require applicable entities to compete for a limited pool of competitive grant dollars.

How does Direct Pay work?

Applicable entities eligible for direct pay 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 direct 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?

- 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 (for certain credits).
- By and large, the bonus provisions are designed to incentivize the creation of good paying jobs, domestic sourcing of materials, 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 direct 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.

What types of projects might be eligible for Direct Pay?

- Direct pay will allow applicable entities to do things differently and to do different things.
  - For example, Williamsfield Schools anticipates receiving $100,000 in IRA tax credits for electric school buses and 11 Electric Vehicle charging stations that were put into service in 2023.
    - The Williamsfield Schools district has already received $2.7 million from the EPA's Clean School Bus Program which can be used with direct pay.
  - Manchester Public Schools anticipates receiving $2.5 million in IRA clean energy tax credits for installing ground source heat pumps and solar panels.

Direct Pay is a powerful new financial tool to make necessary investments to achieve goals related to the clean energy transition, such as improved health outcomes, reduced reliance on the grid and potential cost savings.

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

Using Direct Pay with Grants and Loans

- The direct pay final rule includes a special provision 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 on Direct Pay
  - ✓ IRS.gov/ElectivePay
    - ✓ Pre-filing Registration User Guide; How-to-Video
    - ✓ Permission Management User Guide
    - ✓ FAQs
  - ✓ CleanEnergy.gov/DirectPay
  - ✓ Subscribe to IRS e-News Subscriptions by visiting IRS.gov/newsroom/e-news-subscriptions → Tax exempt & government entities
- More information on the IRA
  - ✓ Treasury.gov/IRA
  - ✓ IRS.gov/CleanEnergy
  - ✓ www.whitehouse.gov/cleanenergy/inflation-reduction-act-guidebook/

Appendix

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 (also known as Direct Pay)**, a novel tax credit delivery mechanism created by the Inflation Reduction Act.

How Elective 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.

Using Elective Pay with Grants and Loans

Example 1: 45W

- 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.

Example 2: Section 48 ITC

- A higher education institution receives a tax-exempt grant in the amount of $2,000,000 to install a solar farm on its main campus.
- The institution installs the solar farm for $10,000,000, using the grant and $8,000,000 of the institution’s unrestricted funds.
- Under IRA, the institution is eligible for a section 48 Investment Tax Credit for its investment in the solar farm. The base credit is 6%. But because the institution has met prevailing wage and apprenticeship requirements, and the solar farm is located in an energy community, the ITC credit rate is enhanced to 40%.
- The institution’s basis on the solar farm is $10,000,000 and the institution’s ITC credit is $4,000,000.
- Since the amount of the restricted tax-exempt grant plus the amount of the ITC credit ($6,000,000) is less than the cost of the solar farm ($10,000,000), the institution’s ITC credit is not reduced due to the grant.

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 after earning the underlying credit.
  - 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.
  - **Registration is not a determination of the amount or validity of a credit**
- File your tax return by the due date (or extended due date) and make a valid direct pay election.
  - Provide your registration number on your tax return as part of making the direct 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.

Addressing Some Common Questions about Direct Pay

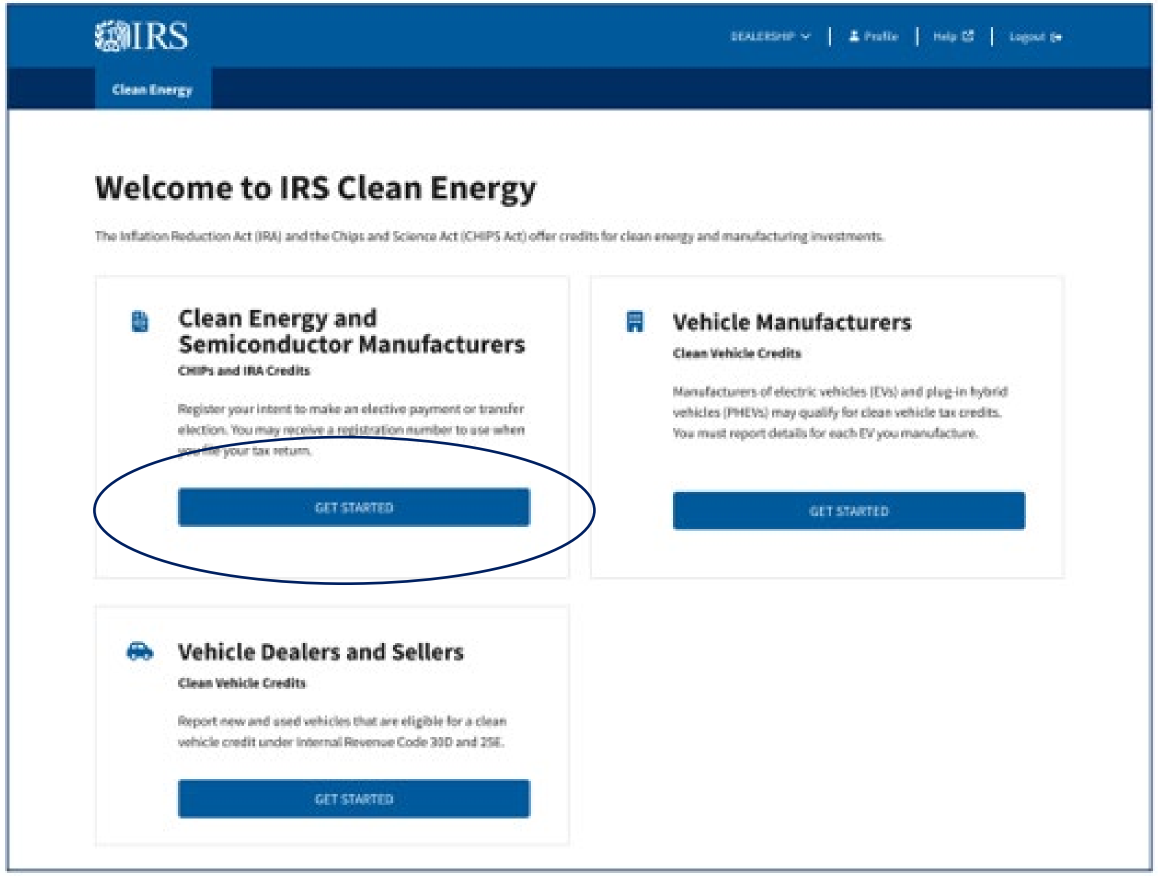
- **What are the risks associated with direct pay? For example, what happens if I unexpectedly run out of funding to complete the project?**
  - **Applicable entities should not file for direct pay unless they have earned the underlying credit. Entities need to be willing to commit the resources to address the two primary areas of risk -- project completion and compliance.**
    - Project completion risk is related to the failure to put a project into service. For example, a non-profit organization develops a project to install a microgrid but for a variety of reasons, the project is never completed. The project would not be eligible for direct pay.
    - Compliance risk has to do with ensuring that a fully completed project meets all the underlying requirements of the applicable tax credit and any bonus provisions that are being claimed. Failure to do so could result in loss of all or part of the value of the credit.
    - Both project completion risk and compliance risk are common issues for many applicable entities when they receive Federal funding through grants or when they benefit from other provisions of the tax code. Grant funding can be rescinded when a project is not completed or when a grant recipient has not complied with the terms of a grant.

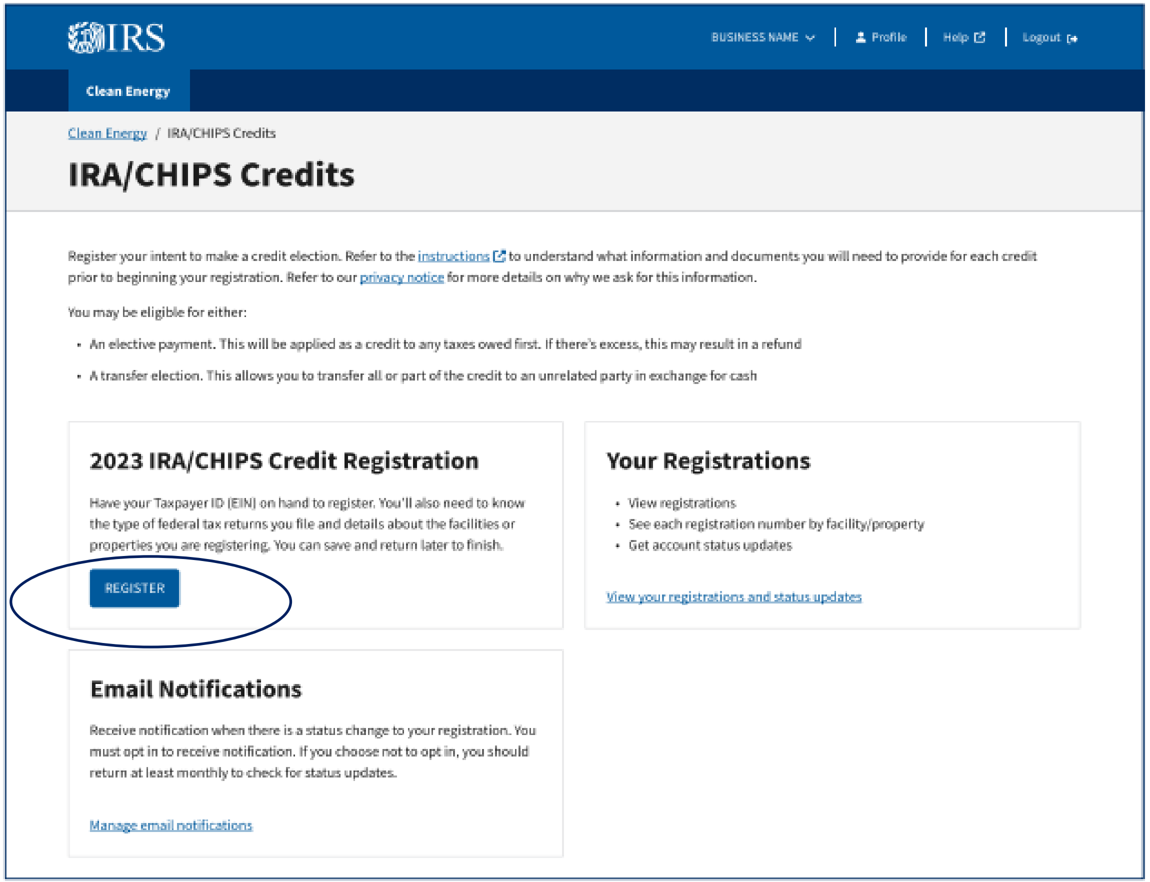
Addressing Some Common Questions about Direct Pay

- **If the payment doesn't come until after a project has been put in service, where does the up-front funding come from?**
  - Using bridge or debt financing of the project generally does not affect the direct payment election. Tax-exempt bonds may result in a reduction of the underlying credit amount.
  - The back-end process for direct pay – where payment does not come until after a project is complete and in service -- is not very different from Federal funding where state and local governments are reimbursed for actual costs, such as in the case of FEMA disaster funding.
- **My organization is very small, and I worry that this is all too complicated to implement.**
  - Every organization needs to make a judgment as to whether they can effectively and efficiently implement projects that could benefit from financing through direct pay. For smaller organizations with concerns about capacity, there may be several operational alternatives to consider, including:
    - Seeking and receiving technical assistance and advice from other organizations, including state governments and non-profit organizations
    - Pursuing projects where other, higher capacity applicable entities may play the lead role in project development and seek and receive direct payment

Pre-Filing Registration: Step by Step

You must first create a Clean Energy Business Account for your organization at www.irs.gov/eptregister. You will then begin the registration process below. Only an authorized representative of the entity may register and provide information and this representative's personal identity will be verified during the registration process.





A comprehensive user guide and video tutorial can also be found at [www.irs.gov/eptregister.](www.irs.gov/eptregister)

Pre-Filing Registration: Step by Step

Registrant Type *

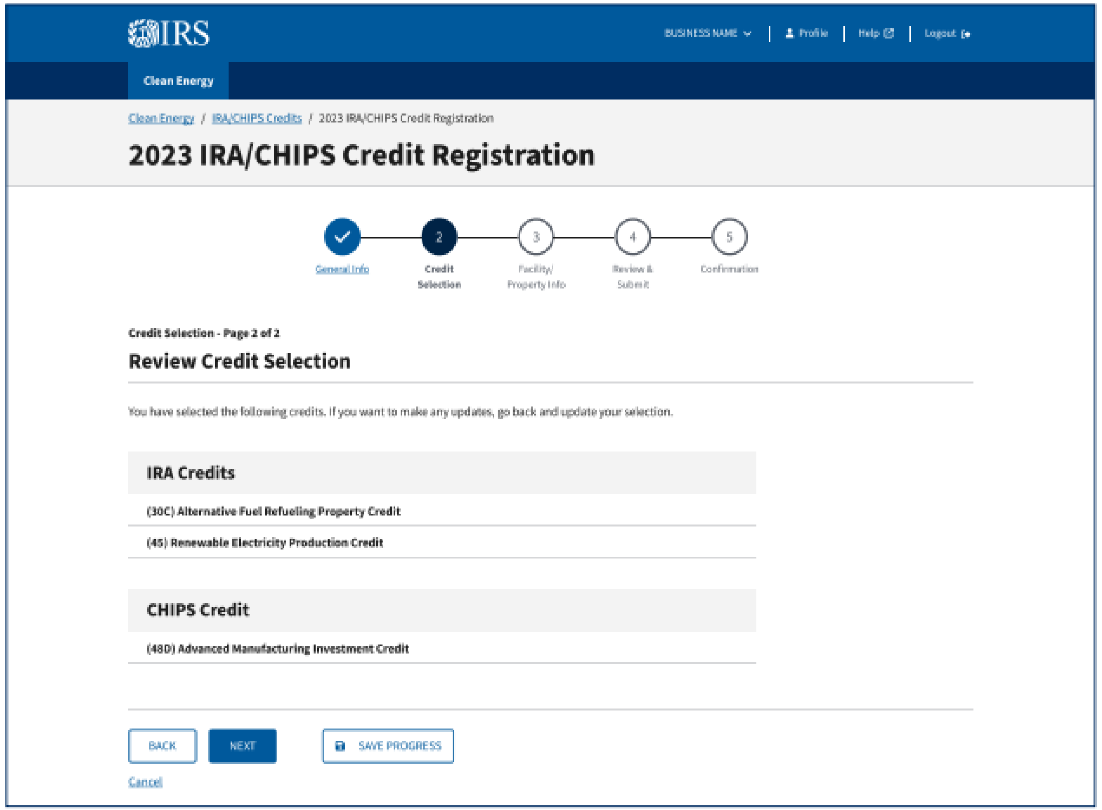
Unsure of your registrant type? See the definitions at the bottom of the page

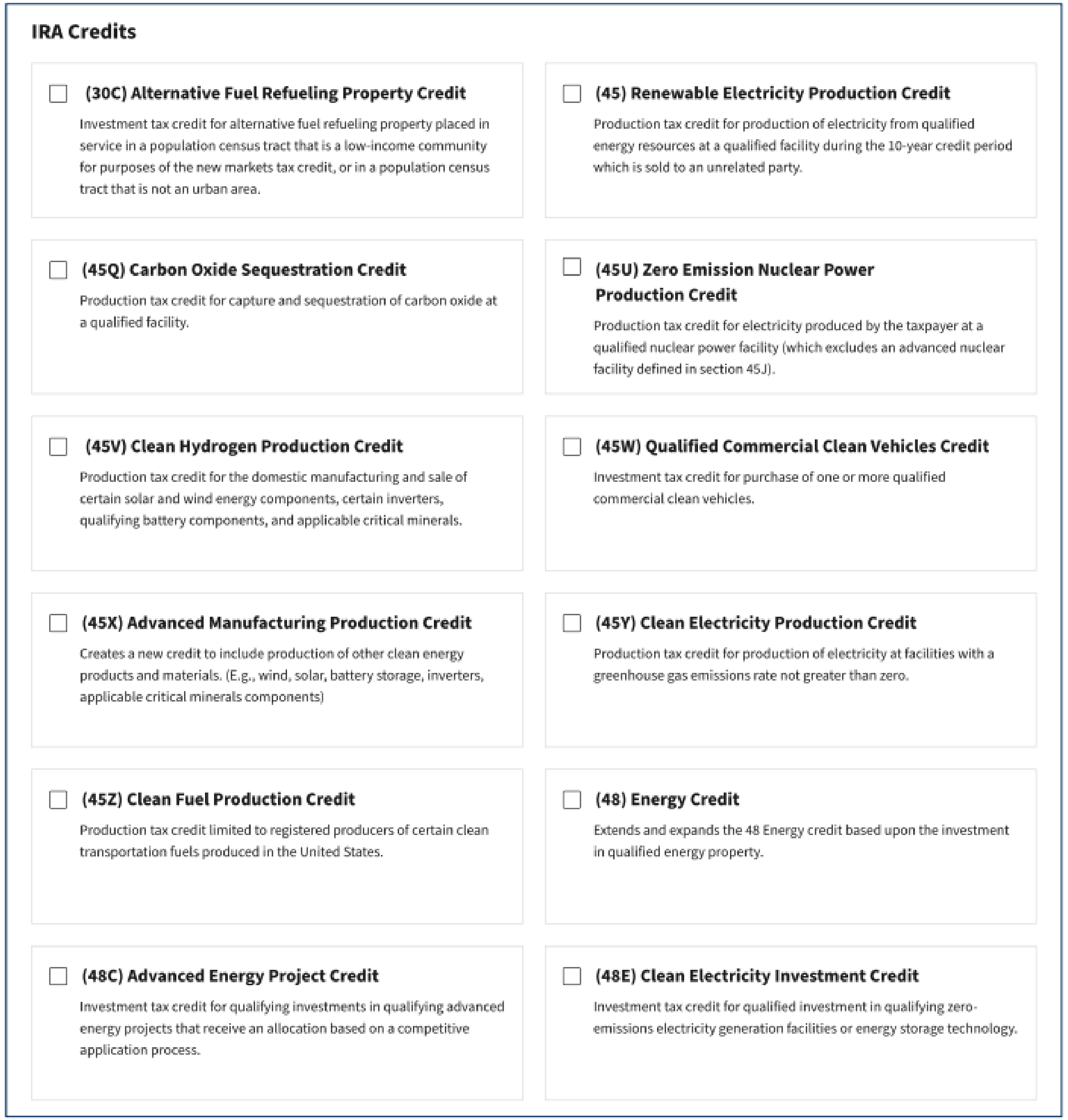
- Organization exempt from the tax imposed by subtitle A by reason of Section 501(a) of the Code
- Government of any U.S. territory or a political subdivision thereof (including an agency or instrumentality)
- State, the District of Columbia, or political subdivision thereof (including an agency or instrumentality)
- Indian tribal government or a subdivision thereof (including an agency or instrumentality)
- Alaska Native Corporation (excluding an Alaska Native Settlement Trust)
- Tennessee Valley Authority
- Rural electric cooperative
- Partnership
- S corporation
- C corporation
- Real Estate Investment Trust
- Sole Proprietorship
- Trust
- Other

- The user guide contains descriptions for each option if you are unsure of your registrant type
- Prior to providing credit specific information, you will also be asked for:
  - Address information – provide the address used on the registrant's last annual return or last employment tax return.
  - Banking information
  - Information about returns filed

Pre-Filing Registration: Step by Step

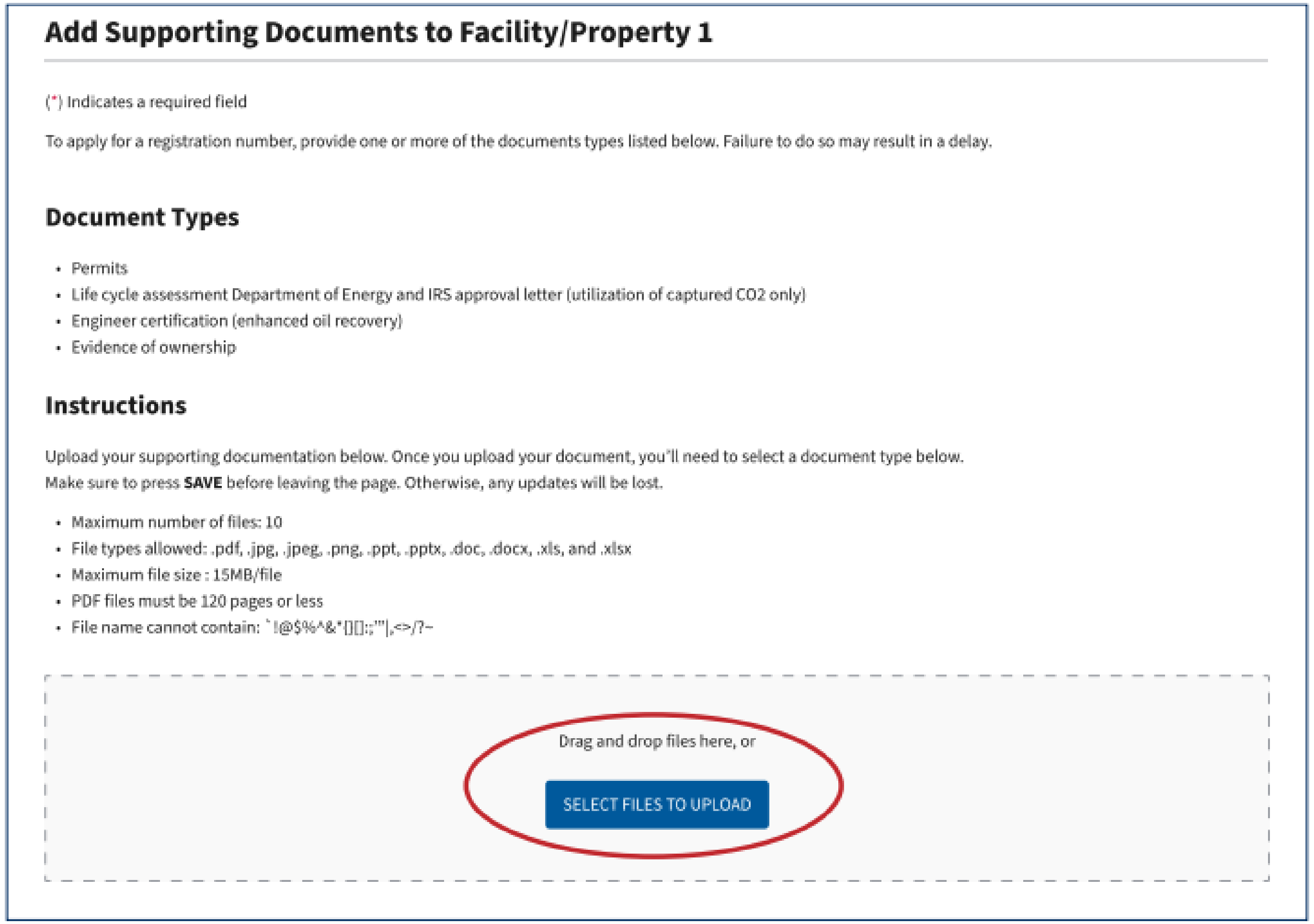
- Select the credits your organization intends to claim using direct pay.
- Specific information will be required for each credit.





Pre-Filing Registration: Step by Step

- The registrant will need a separate pre-filing registration number for each facility/property.
- In addition to providing credit specific information, such as the location of the facility, you will need to provide supporting documentation.
- The user guide offers additional details, including how to use the bulk upload option.



Add Supporting Documents to Facility/Property 1

(*) Indicates a required field

To apply for a registration number, provide one or more of the documents types listed below. Failure to do so may result in a delay.

Document Types

- Permits
- Life cycle assessment Department of Energy and IRS approval letter (utilization of captured CO2 only)
- Engineer certification (enhanced oil recovery)
- Evidence of ownership

Instructions

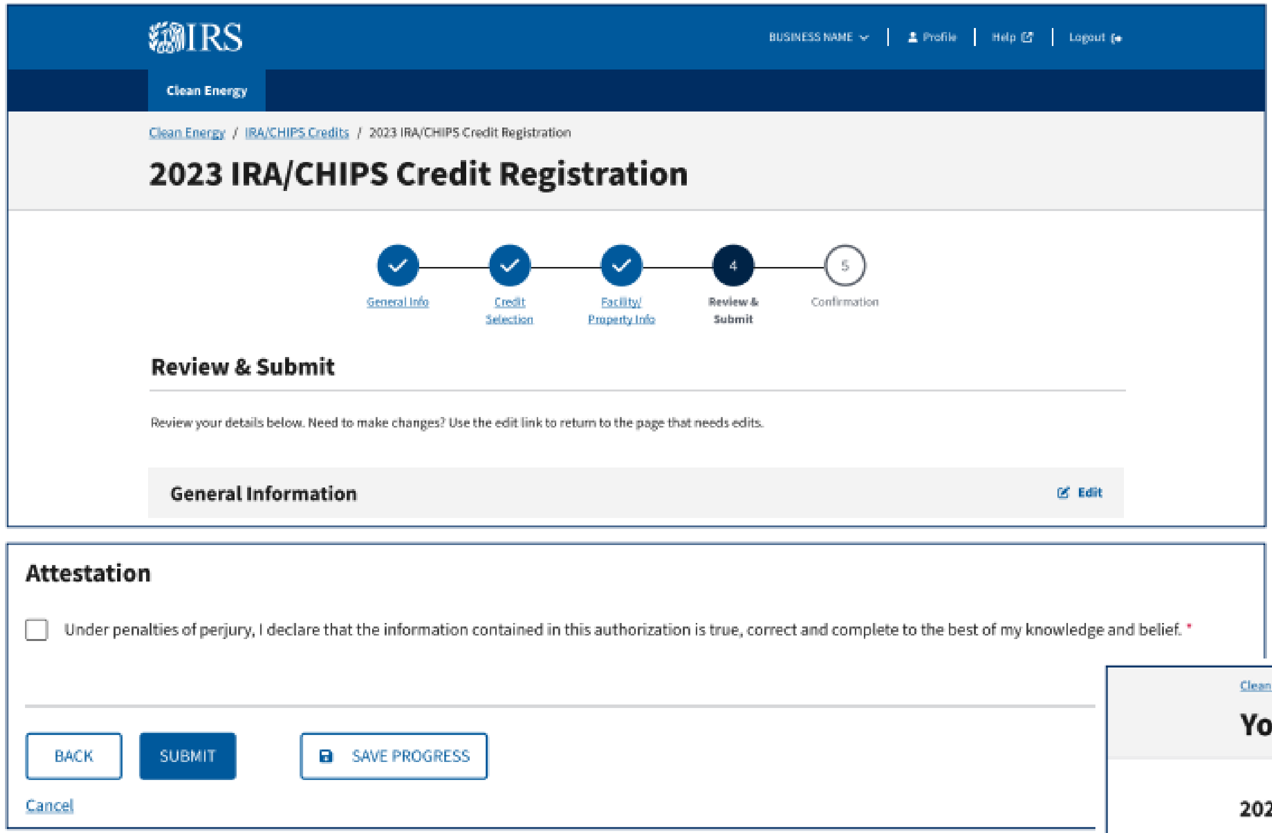
Upload your supporting documentation below. Once you upload your document, you'll need to select a document type below.
Make sure to press **SAVE** before leaving the page. Otherwise, any updates will be lost.

- Maximum number of files: 10
- File types allowed: .pdf, .jpg, .jpeg, .png, .ppt, .pptx, .doc, .docx, .xls, and .xlsx
- Maximum file size : 15MB/file
- PDF files must be 120 pages or less
- File name cannot contain: ` !@$%^&*{}[]:;'"|,<>/?~

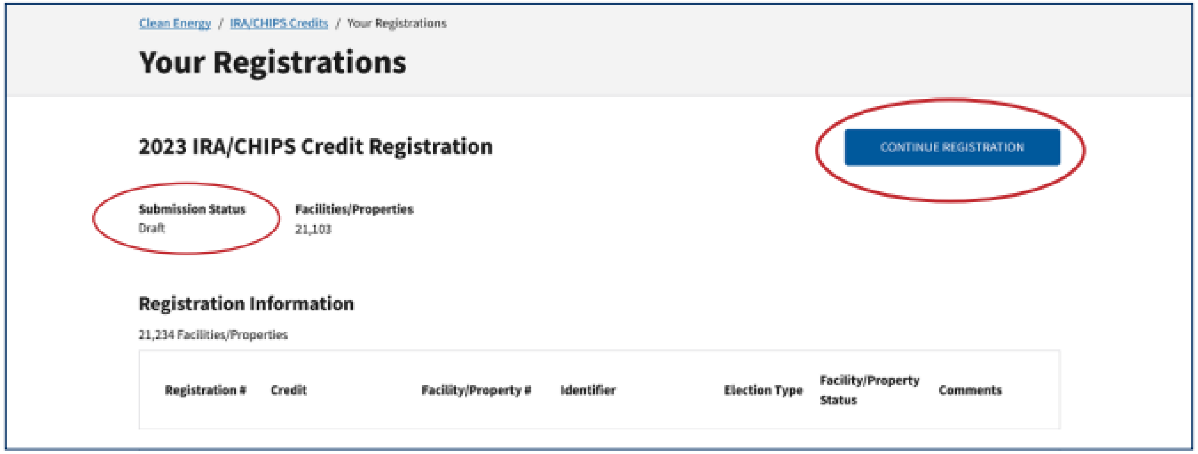
Drag and drop files here, or

SELECT FILES TO UPLOAD

Pre-Filing Registration: Step by Step



- You can save your work in progress.
- Until you submit the registrant's registrations for review, the "CONTINUE REGISTRATION" option will appear, and the Submission Status will show as "Draft."
- Review and, when accurate and complete, submit your requests for registration numbers.

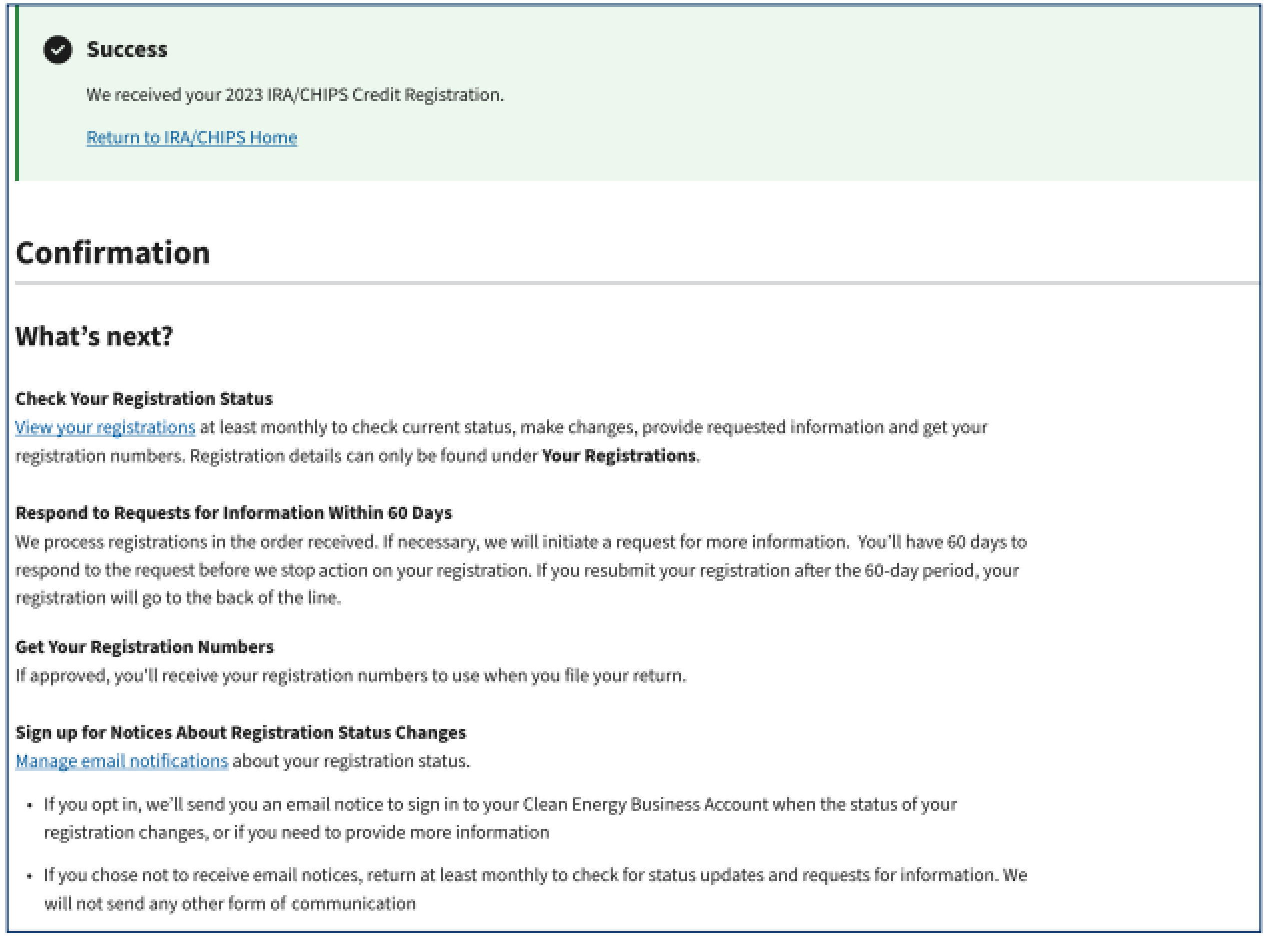


Pre-Filing Registration: Step by Step

- After you submit a registration package, you can monitor its status in the "Your Registrations" site.

- A registration submitted for review cannot be changed until it is:
  - Returned with registration numbers or;
  - Returned with comments that explain why registration numbers were not issued.

- Your submission status will appear as one of the following:
  - Awaiting Assignment
  - Under Review
  - Returned
  - Returned – Closed
  - Returned – Open



Success

We received your 2023 IRA/CHIPS Credit Registration.

Return to IRA/CHIPS Home

Confirmation

What's next?

Check Your Registration Status

View your registrations at least monthly to check current status, make changes, provide requested information and get your registration numbers. Registration details can only be found under **Your Registrations**.

Respond to Requests for Information Within 60 Days

We process registrations in the order received. If necessary, we will initiate a request for more information. You'll have 60 days to respond to the request before we stop action on your registration. If you resubmit your registration after the 60-day period, your registration will go to the back of the line.

Get Your Registration Numbers

If approved, you'll receive your registration numbers to use when you file your return.

Sign up for Notices About Registration Status Changes

Manage email notifications about your registration status.

- If you opt in, we'll send you an email notice to sign in to your Clean Energy Business Account when the status of your registration changes, or if you need to provide more information
- If you chose not to receive email notices, return at least monthly to check for status updates and requests for information. We will not send any other form of communication

You can revise a submitted registration only once it is returned by the IRS

Addressing Some Common Questions about Direct Pay

- **Does my organization need to own the property to use Direct Pay?**
  - **The organization generally must own the property that generates the eligible credit (or in the case of section 45X otherwise conduct the activities giving rise to the underlying eligible credit).** That ownership can occur through various structures.
    - For example, an applicable entity could directly own the property, could own it through a disregarded entity, or could own an undivided interest in an ownership arrangement treated as a tenancy-in-common or pursuant to a joint operating arrangement that has properly elected out of subchapter K of chapter 1 of the Code (subchapter K) under section 761.

Domestic Content

For projects beginning construction in 2024 or later and claiming production tax credits under Sections 45 or 45Y or investment tax credits under Sections 48 or 48E through elective pay, the credit amount may be reduced if the facility or project does not satisfy domestic content requirements, unless certain exceptions apply.

- Applicable entities may be excepted from the phaseouts if:
    1. the inclusion of steel, iron or manufactured products that are produced in the United States increases the overall costs of construction of qualified facilities by more than 25 percent, or
    2. relevant steel, iron or manufactured products are not produced in the United States in sufficient and reasonably available quantities or of a satisfactory quality.
- Notice 2024-84 extends the transition process for claiming a statutory exception to the elective payment phaseouts.
    - Therefore, if an Applicable Entity provides an attestation and follows the record keeping requirements for an Applicable Credit Property which construction begins before the later of January 1, 2027, or the issuance of further guidance, the Treasury Department and the IRS will treat the attestation as establishing that a Domestic Content Exception is met.