CBOS BETTER ABLE TO FUND CLEAN ENERGY PROJECTS

Understanding IRAs Direct Pay and Transferability Tax Provisions

The Inflation Reduction Act (IRA) introduced two major provisions in the federal tax code that are poised to accelerate our country's clean energy transition: direct pay (also referred to as elective pay) and transferability. These provisions create new mechanisms to make the IRA's commercial energy tax credits accessible to entities that have previously been unable to claim these credits.

Prior to the passage of the IRA, tax-exempt entities, including nonprofit organizations, local governments, and Tribal governments, interested in claiming tax credits towards owning clean energy infrastructure would likely not able to use tax credits, which usually require income tax liability. These deals were either in the form of power purchase agreements (PPAs)[1] or a partnership between a tax equity investor (like a bank) and a solar developer.[2]

For example, if a community-based organization (CBO) completed a solar project with equipment costs of $100,000, they would not be able to receive the 30% Investment Tax Credit (ITC) of $30,000 because, if the CBO is organized as a nonprofit, they are likely to be tax exempt.

Pre-IRA, if a CBO didn't enter into a PPA to access tax credits, they had to absorb the higher cost of getting their project online and often would be forced to compromise on the scale of the project. If a CBO opted for a PPA, the agreement would usually reduce the incentive CBOs had to invest in clean energy projects by changing the ownership or nature of the project.

What is direct pay?

For the first time, direct pay allows non-profit organizations and other tax-exempt entities to receive payments for tax credits claimed for clean energy projects once they are placed in service. These payment amounts are equal to the full value of the applicable credit including any adders, such as the Production Tax Credit and its various bonus credits. Credits under direct pay can be claimed for 5 years starting no later than 2032.[3]

Under the same scenario above, a CBO can receive the $30,000 ITC credit from the IRS under Direct Pay. This amount can include bonuses for projects that meet prevailing wage and apprenticeship requirements. Additional bonuses are available if a project meets domestic content requirements, is located in energy communities,[4] or is built in or serves low-income

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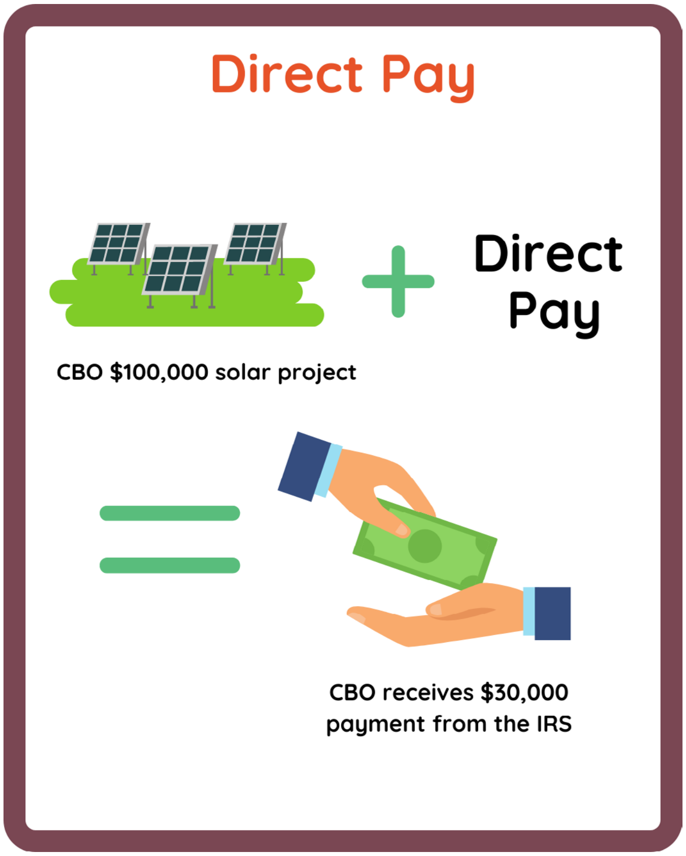
1 Power purchase agreements are financial arrangement in which a third-party developer owns,operates, and maintains a clean energy project in which the host customer agrees to site the system on its property and purchase the system's electric output for a predetermined period. EPA, Solar Power Purchase Agreements.

2 World Resources Institute, 5 Tips for Leveraging the IRA's Direct Pay Provision to Maximize the Benefits of Clean Energy Investment.

3 Clean Energy Group, What Nonprofits Need to Know When Applying for Direct Pay.

4 "Energy communities" are defined as either: 1) a brownfield site; or 2) a metropolitan statistical area where, as of 2009 or later, has a .17

households.[5]



Applying for Direct Pay:[6]

- [ ] Make sure the clean energy project your organization wants to build qualifies for one of the IRA tax credits that qualify for direct pay.
- [ ] Raise up-front capital to complete your project.
- [ ] Place your project in service.
- [ ] Determine the corresponding tax year.
- [ ] Determine when your tax return will be due.
- [ ] Register the project with the IRS to receive a pre-registration number before your tax return is due.
- [ ] Once you receive a pre-registration number, file the required annual tax return by the due date.
- [ ] Receive payment!

Because direct pay works as a reimbursement, CBOs would need to cover the upfront cost of the project through other funding sources. Bridge loans and other financial assistance that will soon be available through the Greenhouse Gas Reduction Fund could help CBOs obtain the

percent or greater in direct employment or 25 percent or greater local tax revenues related to the extraction, processing, transport, or storage of coal, oil, or natural gas and has an unemployment rate at or above the national average for the previous year; or 3) is a census tract or directly adjoining tract in which a coal mine closed after 1999 or in which a coal-firec electric generating unit has been retired after 2009. (See, Interagency Working Group on Coal & Power Plant Communities & Economic Revitalization. Energy Community Tax Credit Bonus.)

5 "Low-income communities" bonus applies to projects located in low-income communities (as defined under the New Markets Tax Credit program), Indian land, qualified low-income residential buildings, or projects where at least 50 percent of the financial benefits of the electricity produced go to low-income households. Unlike most other tax credits, applicants interested in obtaining the Low-Income Communities tax credit must apply with the IRS and receive an allocation from the annual capacity of 1.8 GW to access this credit. (See, IRS. Low-Income Communities Bonus Credit.)

6 Adapted from The White House, Direct Pay through the Inflation Reduction Act.

funding to get started.

With direct pay, tax-exempt entities can directly own clean energy projects in their communities, provide quality jobs, and reinvest the revenue back into the local economy. Since April 2024, more than 1,300 projects or facilities have applied for direct pay. This includes submissions from more than 75 state and local governments for clean buses or vehicles.[7]

What clean energy infrastructure is eligible for direct pay?

Solar panels, wind turbines, fuel cells, geothermal heat pumps, microgrid controllers, and combined heat and power systems are eligible investments under the Investment Tax Credit for Energy Property (48). Commercial Clean Vehicle Credit (45W)[8] can be used for passenger vehicles, buses, ambulances, and certain other vehicles for use on public streets, roads, and highways.

What is transferability?

Entities with clean energy projects can benefit from tax credits even when they do not have sufficient tax liability by selling them on the transfer market. Transferability allows eligible taxpayers, including businesses and other entities that do not qualify for direct pay, to sell all or a portion of any of the 11 clean energy tax credits to a third party. CBOs cannot participate in the transfer market nor can they transfer their direct pay payments. This practice is expected to expand the supply of available financing for clean energy projects by removing the need for private clean energy developers to create complex partnerships with tax equity investors to take advantage of the full value of tax credits.[9]

Since April 2024, more than 900 entities have applied for 59,000 registration numbers for projects or facilities in all 50 states and territories. Approximately 97% of these projects are pursuing transferability with the majority going to solar and wind projects using the ITC or PTC tax credits.[10] Industry reports suggest that in 2023 the Investment Tax Credits (ITC) are priced at 92 cents on the dollar and Production Tax Credits (PTC) are priced at 94 cents on the

7 Department of the Tresury, U.S Department of the Tresury IRS Release Final Rules on Provision to Expand Reach of Clean Energy Tax Credits Through President Biden's Investing in Amercia Agenda.
8 IRS, Clean Energy Tax Incentives: Elective Pay Eligible Tax Credits.
9 Center for American Progress, Understanding Direct Pay and Transferability for Tax Credits in the Inflation Reduction Act.
10 Ibid.

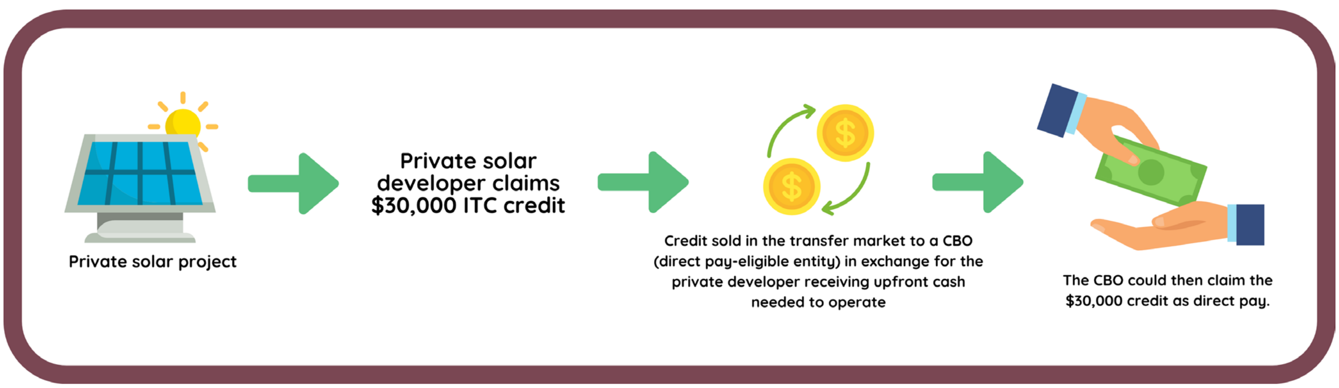
dollar, with conventional solar and wind tax credits priced higher than tax credits for newer technologies.[11]

To protect against bad actors, credits can only be transferred once, avoiding the creation of a secondary market. Individuals, trusts, and closely held corporations are not allowed to participate in the transfer market.

What is "chaining"?

Chaining is a mechanism that is not currently permitted, but is under discussion. Hypothetically, chaining would allow direct pay-eligible entities to buy credits in the transfer market and claim the credit's value under direct pay. This mechanism would expand the market of tax credit buyers, which would particularly benefit small-scale projects which generally face more difficulty obtaining upfront capital needed during project development.[12]

For illustrative purposes, suppose we have a private solar energy project that obtains a $30,000 ITC credit. Assuming that the private developer sells this credit for 92 cents on the dollar in the transfer market to a direct pay-eligible entity, the developer can obtain $27,600 in upfront cash to operate.The direct pay-eligible entity could then claim the $30,000 credit as direct pay.



Non-profits and other tax-exempt entities could potentially participate in "chaining" to support projects in their communities without gathering as much up-front capital and going through the lengthy project development process. This could also help mission-driven entities support the clean energy transition without increasing their entity's risk tolerance or the administrative burden of directly claiming tax credits from the IRS.

11 Crux, Transferable Tax Credit Market Intelligence Report (available for download).
12 Center for Public Enterprise, How Tax Credit "Chaining" Expands the Reach of the IRA Through Greater Public Participation in Project Development.

Under the current rule, a transferee taxpayer can receive a transferred tax credit by:
1. Coming to an agreement with the transferor and obtaining the pre-filing registration number for the specific project ("eligible credit property")
2. Filling out a transfer election statement
3. Filing a tax return and attaching the transfer election statement

The IRS has announced that it may be necessary to change the current rules if chaining is permitted so that a transferor taxpayer identifies the transferee taxpayer to whom the credit is being sold. This would help administer chaining and reduce the possibility of selling duplicate credits. The IRS also raised concerns about potential scenarios where direct-pay eligible entities could buy credits, receive payment, and dissolve afterward. This could result in instances of fraud or improper use of chaining.[13]

How can CBOs get involved?

The IRS is seeking comment on whether it should limit the type or groups of taxpayers or certain situations that allow for chaining and what additional information or documentation eligible entities would need to show to participate in chaining. Interested parties should submit comments by December 1, 2024.

How can I get more information about Direct Pay?

Visit Just Solution's resource hub on tax credits and direct pay at https://justsolutionscollective.org/ira-tax-credit-resources/

13 IRS, Request for Comments on Situations in Which a Section 6417(a) Election Could be Made for Credits Purchased in Transfers Under Section 6418(a).