



Direct Payment of Energy Tax Credits to Public Power Utilities under the Inflation Reduction Act of 2022

The Inflation Reduction Act (IRA) would allow public power utilities to directly benefit from certain energy related credits. The following is brief summary of provisions related to this direct payment.

Overview

The IRA would allow public power utilities, rural electric cooperatives, the Tennessee Valley Authority, and other qualifying tax-exempt entities to directly benefit from certain energy-related credits. While some existing energy-related provisions of the Internal Revenue Code (Code) allow a tax-exempt entity to transfer the value of tax incentives to other taxable entities, this is the first time the Code would allow a tax-exempt entity to, effectively, directly claim tax credits for themselves. Specifically, section 13801 of the IRA creates new Code section 6417 allowing for “elective payment of applicable credits.”

Mechanics

New Code section 6417 allows an “applicable entity” to “elect” to convert an “applicable credit” into a deemed payment of tax equal to the amount of the credit. The owner would then file for a refund from the Internal Revenue Service for this deemed tax “payment.” This mechanism has been referred to as a refundable direct payment tax credit or, more simply, direct payment.

For an entity that already submits annual returns (such as a rural electric cooperative), this election and deemed payment of tax will be included as part of their tax return and the deemed payment could be used to offset an existing tax liability or could be claimed as a refund.

For governmental entities including public power utilities, the IRA directs Treasury to create a mechanism by which an election can be made and a refund can be claimed. This mechanism could be akin to the current mechanism by which state and local entities claim a refund of federal excise taxes on fuels (e.g., IRS Form 8849, Claim for Refund of Excise Taxes).

“Applicable entity”

An “applicable entity” is defined as:

- A tax-exempt entity;
- A tax-exempt organization;
- A state or local government;
- A political subdivision;
- The Tennessee Valley Authority;
- An Indian tribal government; and
- An Alaskan Native Corporation.

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“Applicable credit”

An applicable credit is defined as the:

- The section 30C alternative fuel vehicle refueling property credit;
- Section 45 production tax credit;
- Section 45Q credit for carbon capture and sequestration;*
- Section 45U zero-emission nuclear power production credit;
- Section 45V clean hydrogen production credit;*
- Section 45W commercial clean vehicles credit;
- Section 45X advanced manufacturing production credit;*
- Section 45Y clean electricity production credit;
- Section 45Z clean fuel production credit.
- Section 48 investment tax credit;
- Section 48C advanced energy project credit; or
- Section 48E clean electricity investment credit.

* Taxable entities can also make an election for direct payment of these tax credits.

Timing

Generally, direct payment elections are permitted for taxable years beginning after Dec. 31, 2022, through Dec. 31, 2032. However, the timing of the availability of the underlying credits may vary.

For certain credits, direct payment is only permitted for property or equipment placed in service after December 31, 2022. These credits include the:

- Section 45 production tax credit;
- Section 45Q credit for carbon capture and sequestration; and
- Section 45V clean hydrogen production credit;

Domestic Content Requirement

A project for which an applicable entity is seeking direct payment must meet domestic content requirements. This requirement does not apply where the owner is not seeking direct payment.

Exceptions to the domestic content requirement for purposes of a direct payment election include:

- If the project is smaller than 1 MW;
- If the cost of meeting the domestic content requirement would increase the overall project cost by 25% or more;* or
- If the relevant products are not produced in sufficient “reasonably available” quantities or of a satisfactory quality to meet the domestic content requirement.*

*See, 49 CFR 661 for a further explanation of these two exceptions.

In addition, the domestic content requirement for direct payment is “phased in” over time. Specifically, from 2024 through 2025, even if a project fails the domestic content requirement, it can still qualify for a certain percentage of the otherwise applicable credit. That percentage is:

- 100% of the applicable credit if construction on the project begins before 2024;
- 90% of the applicable credit if construction on the projects begins in 2024; and
- 85% of the applicable credit if construction on the project begins in 2025.

Finally, it is worth noting that projects which meet domestic content requirements are, generally, eligible for a “domestic content bonus credit.” This bonus credit is available whether or not the project owner is seeking direct payment. So, on the one hand, an entity not seeking direct payment and not meeting the domestic content requirement gets no bonus credit, but is still eligible for the base energy credit. On the other hand, an entity seeking direct payment must meet the domestic content requirement and, so, also qualifies for the bonus credit.

Tax-Exempt Financing

Certain applicable credits are reduced to the extent the project is financed with tax-exempt bonds, up to a maximum reduction of 15 percent. For example, a project financed with tax-exempt debt that would otherwise qualify for a 30 percent investment tax credit would instead be eligible for a 25.5 percent credit, or a 2.5 cent per KWH production tax credit would be reduced to 2.125 cents per KWH.

Generally, this limit applies to projects where the construction begins after the date of enactment. However, for purposes of the Section 45Q credit for carbon capture and sequestration, the limit applies to “facilities or equipment placed in service after December 31, 2022.”

The 15 percent reduction for tax-exempt financing applies to the:

- Section 45 production tax credit;
- Section 45Q credit for carbon capture and sequestration;
- Section 45V clean hydrogen production credit;
- Section 45Y clean electricity production credit;
- Section 48 investment tax credit;
- Section 48E clean electricity investment credit.

However, as written, there is no limit in the case of tax-exempt financing for the:

- Section 30C alternative fuel vehicle refueling property credit;
- Section 45U zero-emission nuclear power production credit;
- Section 45W commercial clean vehicles credit;
- Section 45X advanced manufacturing production credit;
- Section 45Z clean fuel production credit; or
- Section 48C advanced energy project credit.

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