Clean Energy Tax Incentives for Government Entities

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Inflation Reduction Act Energy Incentives

Energy Tax Credits Overview

The Inflation Reduction Act made significant changes to energy tax credits

- Significant enhancements and modifications made to existing energy tax credits for solar, wind, EVs, charging stations, etc.
- New credits added for additional technologies and activities
- For many credits, new prevailing wage and apprenticeship requirements must be met to receive highest available credit
- Additional “bonus” credit rates are possible - depending, *inter alia*, on where the property is placed in service and domestic content requirements
- **New “direct pay” election allows most tax-exempt and some government entities to access credits by making them “refundable”**
- Transferability election allows other taxpayers to monetize credits

Section 6417 – Direct Pay Election

- **Tax-exempt and governmental entities can make a "direct pay" election and receive a cash refund for the amount of several specified credits.**

- **The statute includes provisions designed to "turn off" the limitations in the pre-existing law that kept tax-exempt and government entities from participating in the tax incentive.**

- **Effective for tax years beginning after December 31, 2022.**

Section 6417 - Direct Pay Election

(a) In general

In the case of an **applicable entity** making an **election** (at such time and in such manner as the Secretary may provide) under this section with respect to any **applicable credit** determined with respect to such entity, such entity shall be treated as making a **payment against the tax** imposed by subtitle A (for the taxable year with respect to which such credit was determined) **equal to the amount of such credit**.

- *If the deemed "payment" exceeds the entity's tax liability, it will receive a cash refund for the difference between the credit amount and its tax liability.*

Direct Pay Election – Applicable Entities

Proposed regulations clarify that the term "applicable entity" includes a variety of tax-exempt and governmental entities not expressly mentioned in the statute, including:

- Governments of U.S. territories and their political subdivisions
- Tax-exempt entities in U.S. territories
- District of Columbia
- Subdivisions of Indian tribal governments
- **Agencies and instrumentalities of any state, the District of Columbia, Indian tribal government, U.S. territory or political subdivisions of any of the foregoing**

Direct Pay Election Mechanics

Applicable entity must make the direct pay election to access credit

– Election must be made on an original annual tax return, no later than the due date (including extensions), with additional required forms
  - What do I do if I don't file an annual IRS return?
    - Form 990-T, *Exempt Organization Business Income Tax Return*, with attached Form 3800, *General Business Credit*
  - When is the IRS Form 990-T due?
    - The original due date is four and a half months after the end of the tax year
    - A political subdivision has until the extended due date of the return for the applicable tax year to file a 990-T.
    - Example: 06/30/2024 tax year end, original return due date is 11/15/2024 and extended due date is 5/15/2025

Direct Pay Election Mechanics

The Secretary may require information or registration deemed necessary to prevent **duplication, fraud, improper/excessive payments**

- Online pre-filing registration is required
  - Registration number required for entity and for each credit property
  - Registration number for credit property is only valid for specified year; may need to amend registration if timeline or other information changes

Penalty for “excessive payments” = 20% of the “excessive payment” (just excessive payment amount if reasonable cause is demonstrated)

Applicable Credits

Pre-IRA credits (now with a direct pay option):

- **Sec. 30C – Alternative fuel vehicle refueling property credit**
- Sec. 45 – Electricity produced from certain renewable resources (but only for projects originally placed in service after 12/31/2022)*
- Sec. 45Q – Credit for carbon oxide sequestration (but only for projects originally placed in service after 12/31/2022)
- **Sec. 48 – Energy credit***
- Sec. 48C – Qualifying advanced energy project credit

* Special phaseout rule for direct pay if domestic content requirements aren't satisfied.

Applicable Credits (cont.)

New Credits (with a direct pay option):

– Sec. 45U – Zero-emission nuclear power production credit
– Sec. 45V – Credit for production of clean hydrogen (but only for projects originally placed in service after 12/31/2022)
– **Sec. 45W – Credit for qualified commercial clean vehicles**
– Sec. 45X – Advanced manufacturing production credit
– Sec. 45Y – Clean electricity production credit*
– Sec. 45Z – Clean fuel production credit
– **Sec. 48E – Clean electricity investment credit***

* Special phaseout rule for direct pay if domestic content requirements aren't satisfied.

Overview of § 48/48E Investment tax credit (ITC)

One-time investment tax credit (ITC) equal to a percentage of the eligible basis of qualifying energy property placed in service during the taxable year.

Eligible basis* ✖ **ITC %** = **ITC**

Eligible Basis

- Compute eligible basis based on project costs
- Cost segregation analysis identifies eligible vs. ineligible direct costs
- Generally indirect costs allocated based on direct costs

ITC %

- Base rate
- Prevailing wage & apprenticeship bonus
- Domestic content bonus (or reduction)
- Energy community bonus
- Environmental justice bonus

Section 48 Energy Credit

Section 48 is generally available for property that begins construction **before 2025**

- *But* geothermal heat pump credit available if construction begins before 2035

Approximately 16 types of property qualify under section 48, including:

- Solar energy property
- Combined heat and power system property (cogen)
- Geothermal heat pumps
- Energy storage technology
- Thermal energy storage property
- Fuel cell powerplants
- Microturbine powerplants
- Microgrid controller

Section 48E (New) Energy Credit

– Section 48E is available for property that is **placed in service after 2024**

– Facility must be a “zero emissions” facility (except for energy storage technology and thermal energy storage property)

  - Certain technologies that qualify under section 48 would likely not qualify under new section 48E without carbon capture (*i.e.*, cogen, fuel cells, microturbines)
  - Solar energy property would likely qualify as zero emissions

– Phases out over a three-year period beginning the later of: (i) projects that begin construction after 2032 or (ii) when electric power sector’s carbon emissions are reduced by 75% as compared to 2022 levels

Prevailing Wage & Apprenticeship Requirements

- “Bonus rates” are available for projects which satisfy certain wage and apprenticeship requirements during construction and operation of the projects – bonus is generally 5 times the “base rate” (i.e., 30% vs 6% base)

- Meeting prevailing wage and apprenticeship requirements can also be key to getting other top bonus credit rates

Domestic Content

- For several credits, additional up to 10% credit rate may be available if projects are constructed using specified levels of domestically sourced steel, iron, and manufactured products

- For direct pay, main investment and production tax credits **phase out entirely for projects that begin construction after 2025** if domestic content requirements are *not* met (for projects over 1 megawatt)
  - Phase down reductions of the ITC amount of 10% and 15% apply for projects beginning construction in 2024 and 2025, respectively
  - Treasury "shall" provide exceptions if there is insufficient supply or cost would be more than 25% higher

Energy Communities & Low-Income Communities Bonuses

- Additional bonus credit rate of up to 10% available for certain credits for energy projects located in “energy communities” – including brownfields and certain communities formerly reliant on coal and fossil fuel industries
  - Credits impacted: 45, 48, 45Y, and 48E

- Additional bonus credit of up to 10%/20% available for the Section 48 ITC for solar and wind projects in or benefiting certain low-income communities under an allocation program operated by Department of Energy
  - Located in a low-income community or on Indian land
  - Low-income housing projects or low-income economic benefit projects

Credit Amount Adjustments

- Underlying credit provisions (e.g., § 48) may provide that credit amount is reduced if tax-exempt bond financing is used
  - For example, the section 48 investment tax credit may be reduced up to 15% (but not more) if the property is tax-exempt bond financed

- Direct pay proposed regulations would provide reduction of credit amount if property is acquired with income (including grants and forgivable loans) that is exempt from tax and received "for the specific purpose" of acquiring certain "investment-related credit property" but only if the amount of such income plus the direct pay amount exceeds the cost of the property.
  - Credits impacted: Sections 30C, 45W, 48, 48C, 48E

Sec. 45W: Commercial Clean Vehicles Credit

Provides a new credit for qualified commercial clean vehicles (“QCCVs”) acquired for business use/lease by the taxpayer (and not for resale)

Credit is equal to the lesser of:

– 15% of the cost of such vehicle (30% in the case of a vehicle not powered by a gasoline or diesel internal combustion engine), or
– The incremental cost of such vehicle.
  - The incremental cost of a qualified commercial clean vehicle is the excess of the purchase price for the clean vehicle over the price of a comparable vehicle (one powered solely by a gasoline or diesel internal combustion engine comparable in size and use)

Sec. 45W: Commercial Clean Vehicles Credit (cont.)

- Maximum credit:
  - QCCVs with a gross vehicle weight rating under 14,000 lbs: $7,500
  - All other QCCVs: $40,000

- New credit for “mobile machinery” – e.g., commercial lawnmowers

- Effective for vehicles acquired in 2023 through 2032

- ***No prevailing wage or apprenticeship requirements***

Sec. 30C: Electric Vehicle Charging Stations Credit

Extension of EV charging stations credit (§ 30C)

- Up to 30% of qualifying costs (“bonus rate”) if prevailing wage and apprenticeship requirements are satisfied, otherwise 6% (“base rate”)
- Business credit cap increased from $30,000 to $100,000
  - ***Note that credit is now only available for charging stations installed in census tracts that qualify as low-income communities (as defined under the new markets tax credit) or in census tracts that are not urban census tracts***
- Credit available for property placed in service before 2033 and changes/enhancements to the credit are effective for property placed in service after 2022

Sec 179D: Energy efficient commercial building deduction

- Under prior law, section 179D provided a tax deduction of up to $1.80 per square foot for energy efficient commercial building property
  - In the case of a government owned building, the deduction could be allocated by the government entity to the designer of the property.

- The Inflation Reduction Act **increased the available deduction amount (to up to $5 per square foot)** and provides that **the deduction can also be allocated to the designer in the case of buildings owned by tax-exempt entities**.

- Maximum deduction is only allowed if prevailing wage & apprenticeship requirements are satisfied.

Q&A

Bios

Katherine Breaks

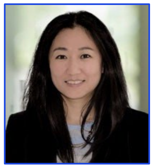
WNT Principal - Passthroughs, Incentives, Credits, and Methods

Katherine specializes in advising clients on energy tax credits and other federal income tax credits. This work has included assisting companies in developing tax-efficient investment structures, including:

- Advising on transactions involving the so-called "flip structure" and "inverted lease"
- Performing due diligence reviews and risk assessments
- Preparing tax opinions
- Reviewing financial models and analyzing credit qualification
- Providing general federal income tax advice

Recent projects have included:

- Providing due diligence services in connection with acquisition of a wind project, including reviewing tax components of financial model
- Providing advice on the "begin construction" requirements under Notices 2013-29, 2016-31 and 2018-59
- Advising on solar monetization structures pertaining to the inverted lease and flip structures
- Providing advice on the so-called 80/20 test that allows repowered wind projects to claim a new 10-year credit period
- Evaluating ITC studies for ITC eligibility



Yingying Qian

Managing Director – Accounting Methods and Credits

Yingying is a Managing Director in the Accounting Methods and Credits Services ("AMCS") group and leads the Credits practice of the group for New England and Upstate New York. Yingying specializes in federal and state tax credits and incentives including the Energy (IRA) Credits, R&D Credit, Employee Retention Credit, and various states programs.

Yingying has over 18 years of experience advising clients on identifying, quantifying, documenting and substantiating the various tax credits. Her client portfolio includes tax exempt organizations and US multi-national and domestic companies in a wide variety of industries including manufacturing, technology, software, life science & pharmaceuticals, banking and insurance, and food & beverage, etc.

Yingying has extensive experience managing and delivering tax consulting engagements. Her experiences include:

- Scoping, estimating and benchmarking potential tax credit benefits;
- Developing and implementing client-tailored methodology and work plan;
- Identifying, quantifying and documenting qualified activities and expenditures;
- Supporting and representing clients in federal and state audits, developing acceptable audit methodologies and proposals for settlement.

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