AMERICAN PUBLIC POWER ASSOCIATION
Powering Strong Communities

ISSUE BRIEF January 2023

Direct Pay Tax Credits

- In implementing the ability to receive refundable direct payment tax credits under the Inflation Reduction Act (IRA), Treasury should strive to make rules and regulations as simple and efficient as possible to maximize investments and avoid locking out smaller entities with needless paperwork.
- Congress should consider further amendments to the IRA to encourage investments in smaller and rural communities. For example, a 5-megawatt (MW) exception from the domestic content requirement for receiving a refundable tax credit may be adequate for a small community solar project, but likely too small to be of any use for the vast majority of even the smallest public power utilities.
- Congress should remove the threat of sequestration from refundable direct payments, whether by waving the Statutory Pay as You Go Act (PAYGO) requirements for prior legislation, or specifically exempting refundable direct pay tax credits from PAYGO.

Background

Since the mid-1900s, Congress has incentivized energy investments and energy production through direct federal grants, subsidized loans, and/or loan guarantees. Since the 1980s, this has been done increasingly, and now predominantly, through the federal tax code.

These tax credits are not intended to provide generalized relief from an owner's tax liability, but to encourage investments in renewable energy by reducing the financial cost of the investment. However, tax-exempt entities, including public power utilities, cannot directly benefit from either the investment tax credit (ITC) or production tax credit (PTC) for a facility that they own. Some entities with little to no tax liability jointly own qualifying facilities with a "tax equity" partner whose sole role is to monetize an ITC or PTC. However, a public power utility cannot feasibly enter this sort of "partnership flip" transaction.[1] Public power utilities can indirectly benefit from such credits by entering long-term power-purchase agreements with taxable entities that can claim these credits. However, the transactional costs of such agreements can be high. Additionally, only a portion of the value of the tax credit is generally considered to be passed on to the purchaser, thus muting the incentive effect.

These costs and limitations are problematic in that tax-exempt entities serve a substantial percentage of the nation's retail electric customers (15 percent by public power and 12 percent by rural electric cooperatives). Additionally, omitting tax-exempt entities from energy-related tax incentives makes it more costly for public power utilities to make investments in renewable and other non-emitting resources and clean energy technologies that will be needed to reduce greenhouse gas emissions to address climate change. This is a significant shortcoming if Congress is seeking market-wide changes in energy-related investment and production decisions.

1 Even the partnership flip has significant limitations, including substantial transaction costs, making it economically viable for only large projects (in the range of $50–$200 million); see, Nat'l Rural Elec. Coop. Ass'n, Cooperative Utility PV Field Manual: Volume I: Business Models and Financing Options for Utility-Scale Solar PV Installations (2015), at 51.

Congressional Action

Over the last several decades, Congress has tried numerous methods of addressing these problems. In 1992, Congress authorized Renewable Energy Production Incentives (REPI) for public power utilities and rural electric cooperatives, which sought to provide direct payments comparable to the PTC earned by taxable entities. However, during the 15 years in which REPI funds were appropriated, public power utilities and rural electric cooperatives qualified for $329 million in REPI payments, but Congress only appropriated $54 million. After 2009, Congress stopped appropriating funds for REPI entirely.

In the Energy Policy Act of 2005 (EPAct05), Congress sought to provide an investment incentive for certain tax-exempt entities akin to the ITC by creating the Clean Renewable Energy Bond (CREB). Qualified CREB issuers included public power utilities, states, localities, and rural electric cooperatives. Interest paid on a CREB is taxable, but the CREB holder receives a tax credit. However, tax credit bonds are quite complex, and issuers had a difficult time finding willing buyers. As a result, in 2010, Congress modified CREBs (now called New CREBs) to allow issuers the option of receiving a direct payment from Treasury in lieu of providing bond holders a tax credit.[2] Since their inception, CREBs and New CREBs were hamstrung by an overall volume limit, which never exceeded $2.4 billion, and a laborious allocation process. Then as part of the Tax Cuts and Jobs Act of 2017, Congress prohibited the issuance of any additional New CREBs.

In some instances, Congress has allowed for the transfer of tax benefits from tax-exempt entities to taxable entities. For example, in EPAct05, Congress expanded on existing tax preferences for clean-fuel motor vehicles by creating a tax credit for the purchase of an alternative fuel vehicle, including hybrid vehicles. Under the statute, if the purchaser is a tax-exempt entity, the tax credit automatically transfers back to the vehicle's seller. Identical language was included in 2008, when Congress provided a tax credit for plug-in electric drive motor vehicles.

In 2018, Congress modified two existing ITCs (one for carbon capture and sequestration, the other for advanced nuclear facilities) to allow for transferability.[3] Now the carbon capture and sequestration tax credit can be transferred from the purchaser of the carbon capture facility to the person that disposes of the carbon dioxide (CO_2), uses the CO_2, or uses the CO_2 as a tertiary injectant. Similarly, the advanced nuclear tax credit now can be transferred to another "eligible project partner." These policy changes put public power utilities on a more level-playing field with other electricity providers and allow them to make investments in technologies and projects that will reduce CO_2 emissions.

Most recently, the IRA extended and expanded existing energy tax credits, but also sought to make these credits available to all entities, including public power utilities and rural electric cooperatives. Under the new law, these entities can claim these credits as refundable direct payment tax credits. In effect, the owner is deemed to have made a tax payment equal to the amount of the tax credit, and therefore qualifies for a tax refund. The efficacy of this provision has been severally handicapped, though, by the threat of PAYGO Sequestration (For more information, please see APPA's issue brief, "Sequestration of Bond and Tax Credit Payments").

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2 Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111-147, 124 Stat. 71.
3 Bipartisan Budget Act of 2018, Pub. L. 115-123, 132 Stat. 63.