ISSUE BRIEF June 2023

Elective Pay Tax Credits

- Rules implementing refundable elective payment tax credits under the Inflation Reduction Act (IRA) must be as simple and efficient as possible to maximize investments and avoid burdening public power utilities' projects with burdensome paperwork.
- Domestic content rules appear to require burdensome recordkeeping and an unlikely level of cost disclosure from suppliers. Requirements that are impossible to meet will not actually encourage domestic production.
- Congress should consider further amendments to the IRA to encourage investments in smaller and rural communities. For example, a one-megawatt (MW) exception from the domestic content requirement for receiving a refundable tax credit may be adequate on a neighborhood 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 elective payments, whether by waving the statutory Pay as You Go Act (PAYGO) requirements for prior legislation, or specifically exempting refundable elective pay tax credits from PAYGO.

Background

Currently, the U.S. Department of Treasury (Treasury) and Internal Revenue Service (IRS) are in the midst of drafting regulations allowing tax-exempt entities to take an elective payment (also known as direct payment) of certain energy tax credits.

Elective payment was created as part of an expansion and extension of existing energy tax credits under the IRA.[1] Under the new law, tax-exempt entities, including public power utilities, can claim certain energy tax credits as refundable elective payment tax credits. In effect, the owner, in lieu of an energy tax credit, is deemed to have made a tax payment equal to the amount of the tax credit, and therefore qualifies for a tax refund.

Tax credits eligible for elective payment include:

- Energy investment tax credits (ITCs);
- Energy production tax credits (PTCs);
- The carbon capture and sequestration credit;
- The alternative fuel vehicle refueling property credit;
- The existing nuclear tax credit;
- The clean hydrogen production tax credit;
- The commercial electric vehicle tax credit; and
- The clean fuel production credit.

For elective payment of the ITC and PTC, though, the project must meet certain domestic content requirements, unless:

- Meeting the domestic content requirements would increase project costs by more than 25 percent; or
- Meeting the domestic content requirements requires products that are not available in sufficient quantity or quality; or
- The project is less than one MW in capacity.

Conversely, projects that do meet domestic content requirements not only qualify for refundable elective payment, but also for an additional domestic content bonus credit also created under the IRA.

In May 2023, the Treasury Department and Internal Revenue Service released draft guidance for meeting domestic content requirements but have not released guidance related to domestic content waivers for purposes of qualifying for elective payment. On its face, the draft guidance for meeting the domestic content requirement appears quite challenging. For example, not only would project owners have to track costs and country of origin for project components and subcomponents—for example down to the level of the glue, glass, frame, junction boxes, and edge seals for a photovoltaic module—but could also have to convince suppliers to provide costs, not prices, for each such item. The American Public Power Association (APPA) is concerned that otherwise qualifying elective payment projects may be overwhelmed by burdensome recordkeeping and an unlikely level of disclosure from suppliers. However, until draft waiver guidance is released, APPA cannot say what the full effect of the domestic content requirements will be.

Implementation of elective payment credits is critically important. Without elective payment, tax-exempt entities, including public power utilities, could not directly benefit from energy tax credits for facilities they own. Some entities with little to no tax liability could jointly own qualifying facilities with a "tax equity" partner whose sole role is to monetize an energy tax credit. However, a public power utility cannot feasibly enter this sort of "partnership flip" transaction.[2] Instead, a public power utility that cannot, or does not, seek elective payment will have to indirectly benefit from such credits by entering long-term agreements, such as a power purchase agreement (PPA) with taxable entities that can claim these credits. PPAs can be a means of shifting risk to project developers, but also can come with high transactional costs. 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. Recent analysis shows that for tax years 2018 through 2020, roughly 60 percent of ITC and PTC credits went to banks, insurance companies, and other financial entities serving as tax-equity partners.[3]

Transferability

In addition to PPAs and elective payments, some energy-related tax credits can be monetized by a public power utility by transferring the credit. This includes credits for alternative fuel vehicles, including hybrid vehicles, plug-in electric drive motor vehicles, carbon capture and sequestration, and advanced nuclear facilities. Transferability does allow tax credits to be claimed for assets owned by public power utilities. However, the project owner must still rely on a counterparty with a need for tax credits in such a transaction, which likely means the asset owner will not realize the full value of the credit.

Congressional Action

In April 2023, the House of Representatives passed on a party-line vote H.R. 2811, the Limit, Save, Grow Act of 2023, a bill to increase the federal debt limit, but which would also have repealed the bulk of the IRA, including refundable elective pay tax credits. The energy tax credit provisions were eventually dropped from debt limit legislation later enacted into law, and at least one amendment proposed for consideration during House debate of H.R. 2811, by Rep. Derrick Van Orden (R-WI), would have preserved refundable elective pay tax credits. Subsequently, House Ways & Means Committee Chairman Jason Smith (R-MO) introduced H.R. 3938, the Build It in America Act, which would repeal the extension and expansion of the ITC and PTC, but retain elective payment of other energy tax credits, including the existing ITC and PTC, and credits for carbon capture, alternative fuel refueling property, existing nuclear facilities, clean hydrogen, advance manufacturing, and clean fuel production. APPA is strongly supportive of the

1 Pub. Law 117-169.

2 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.

3 Joint Comm. Taxation, Memorandum: Tentative Energy Credits by Industry (March 23, 2023).

fact that the legislation retains elective payment for these energy credits. Conversely, while APPA has generally not taken a position on which specific technologies should receive tax credits, repealing the modified ITC and PTC without replacement puts a cloud of uncertainty on such investments.

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The American Public Power Association is the voice of not-for-profit, community-owned utilities that power 2,000 towns and cities nationwide. We represent public power before the federal government and protect the interests of the more than 49 million people that public power utilities serve and the 96,000 people they employ.