ISSUE BRIEF January 2025

Elective Pay Tax Credits

- Elective pay tax credits have bipartisan support and ensure that tax-based, federal energy incentives are available to all electric utilities.
- Without elective payment, local communities will pay for projects through power purchase agreements (PPAs), but banks and large corporations will get the tax benefits instead.
- Rules implementing elective payment tax credits must be simple and efficient to maximize locally owned energy production by public power utilities—nearly 1,600 of which serve rural communities.
- Domestic content rules threaten to block local ownership and control of energy production.
- Congress should preserve elective payment and ensure that domestic content rules do not bury viable projects with red tape.

Background

Since the mid-1900s, Congress has routinely sought to incentivize energy investments and energy production. This has been done through direct federal grants, subsidized loans, and loan guarantees, but the most significant and consistent incentives have been provided through the federal tax code. Since the 1970s, Congress has increasingly used federal tax incentives to encourage certain forms of energy investments in the United States. In more recent years, Congress has expanded and extended such incentives to promote non-emitting energy resources and reduce emissions from existing resources to address climate change. Today, tax policy is energy policy, with federal tax credits incentivizing investments in wind, solar, biogas, combined heat and cycle, hydropower, geothermal, energy storage, and nuclear power.

These energy tax credits are not intended to provide generalized relief from an owners' tax liability, but to encourage energy investments by reducing financial costs. However, until elective payment was enacted as part of the Inflation Reduction Act (IRA), tax-exempt entities could not directly benefit from tax credits for a facility that they owned. This included public power utilities and rural electric cooperatives that serve nearly 30 percent of U.S. retail customers, or about 100 million Americans. Instead, these tax-exempt, locally controlled utilities largely indirectly benefited from such credits by entering long-term PPAs with taxable entities that could claim these credits. Such contracts can be expensive and deny the purchaser the benefit of direct ownership and control. Additionally, only a portion of the value of the tax credit was passed on to the purchaser. A Joint Committee on Taxation analysis shows that companies with over $1 billion in sales received more than 90 percent of the value of energy tax credits from 2018 through 2019 and about half of the value went specifically to banks and insurers offering tax-equity to project developers.[1]

1 Robert Harvey, Joint Committee on Taxation, Memorandum, Tentative Energy Credits by Industry (March 31, 2023); Robert Harvey, Joint Committee on Taxation, Memorandum, Distribution Data (March 31, 2023).

As a result, in the last decade, there has been increasing bipartisan awareness that comprehensive energy tax policy must allow all utilities to access federal incentives, including those delivered through the tax code.[2] Thus while the IRA was the result of a partisan process, support for elective payment is bipartisan.

Elective payment allows public power utilities and rural electric cooperatives to monetize energy tax credits for facilities they own. 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.

In addition, the tax code now also includes a new standard for the use of domestic content in certain tax credit projects. Meeting this standard provides a bonus tax credit to any project owner—including taxable and tax-exempt entities—but failing to meet this standard penalizes only tax-exempt owners by denying them access to elective payment of the tax credit. APPA believes this unequal treatment was unintended by lawmakers in drafting the IRA, but the wording of the statute is clear and cannot be changed except by further action of Congress.

To meet the domestic content requirements, 100 percent of the structural steel and iron, and roughly half of the manufactured products used in the facility must be made in the U.S. There are no exceptions to these requirements for qualifying for the domestic content bonus, but there are exceptions for purposes of claiming elective payment, including where:

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

With the first tax-filing season completed, APPA has been generally pleased with implementation of elective payment but remains concerned about the domestic content requirements. Our concerns are twofold—because domestically manufactured products for many types of energy projects are simply not available to meet these requirements and because otherwise qualifying elective payment projects may be overwhelmed by procedures outlined in draft guidance. A "safe harbor" provision does allow owners to calculate whether a project meets domestic content requirements on a much simpler basis and without requiring proprietary supplier information. However, this safe harbor is currently limited to onshore wind, solar, and battery storage projects, meaning that those wishing to claim elective payment for other technologies, such as fuel cells, biogas, waste heat, geothermal, and hydropower, must rely on the unrealistic underlying regime.

Additionally, there is no guidance at all relating to the three waivers (discussed above) to domestic content requirements for elective payment. Under temporary guidance, an entity can "attest" that it has made a good faith determination that it has met the requirements for one of the waivers. This is intended to remain in effect for projects construction of which begins before January 1, 2027, or before new guidance is issued—whichever is later. However, the guidance also could be revoked at any time undermining the business certainty needed to proceed with project development.

2 See, for example, the Energy Sector Innovation Credit Act (H.R. 4720 / S. 2475) which would have allowed for tax credit transferability by public power and rural electric cooperatives introduced in the 117th Congress by Reps. Tom Reed (R-NY) and Jimmy Panetta (D-CA) and five other Republicans and Democrats in the House and Senators Mike Crapo (R-ID) and Sheldon Whitehouse (D-RI) and four other Republicans and Democrats in the Senate. More recently, see for example, Maintaining and Enhancing Hydroelectricity and River Restoration Act of 2021 (H.R. 6653 / S. 2994) that would allow elective payment of the proposed tax credits by public power and rural electric cooperative utilities introduced in the 118th Congress by Reps. Adrian Smith (R-NE) and Suzan DelBene (D-WA) and four other Republicans and Democrats in the House and by Senators Maria Cantwell (D-WA) and Lisa Murkowski (R-AK) and five other Democrats and Republicans in the Senate.

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 carbon capture and sequestration and advanced nuclear facilities. As noted above, tax credit transferability for public power utilities and rural electric cooperatives enjoys broad bipartisan support and has been suggested in the past as a more comprehensive means by which to allow these entities to monetize energy tax credits.

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. An amendment was proposed for consideration during House debate of H.R. 2811, by Rep. Derrick Van Orden (R-WI), which would have preserved refundable elective pay tax credits. The energy tax credit provisions were eventually dropped from debt limit legislation that was subsequently enacted into law. House Ways & Means Committee Chairman Jason Smith (R-MO) later 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, advanced manufacturing, and clean fuel production. APPA appreciates 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 a replacement puts a cloud of uncertainty on such investments.

In anticipation of the expiration of roughly $5 trillion in tax policy at the end of 2025, House and Senate tax-writing committees set up informal working groups and teams to educate committee members on the upcoming policy decisions that must be made, while also giving stakeholders a chance to make their case for retaining or modifying certain provisions, such as elective pay tax credits. As part of this process, some continue to advocate for the wholesale repeal of elective payment and other recent changes made to energy tax credits under the IRA, but a more studied approach seems more likely. To paraphrase lawmakers and staff—not everything will be repealed, by everything is on the menu.

APPA strongly supports retaining the elective payment mechanism and encourages Congress to ensure that domestic content requirements are workable.

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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 54 million people that public power utilities serve and the 96,000 people they employ.

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