AMERICAN PUBLIC POWER ASSOCIATION
Powering Strong Communities

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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

The U.S. Department of Treasury (Treasury) and Internal Revenue Service (IRS) are 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 included in 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.

The IRA also created 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 is 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.

1 Pub. Law 117-169.

To meet domestic content requirements, all the structural steel and iron, and roughly half of the manufactured products, must be made in the U.S. There are waivers for this requirement 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 products that are not available in sufficient quantity or quality; or
- The project is less than one MW in capacity.

The Treasury and IRS have begun releasing guidance related to elective payment, including:

- Temporary and proposed regulations for claiming elective payment (June 2023); and
- Transitional procedures for claiming an exception to the domestic content requirement for claiming elective payment (December 2023); and
- Revised draft guidance for meeting domestic content requirements with a new safe harbor for calculating domestic content percentages (May 2024).

Implementation of elective payment credits is critically important. Without elective payment, tax-exempt entities, including public power utilities, cannot claim energy tax credits for facilities they own. 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. However, under a PPA, only a portion of the value of the tax credit is generally considered to be passed on to the purchaser: instead, the bulk of the benefit of these energy tax credits goes to banks, insurance companies, and other financial entities serving as tax-equity partners.[2]

While APPA has been generally pleased with implementation of elective payment, the association remains concerned about domestic content requirements. Specifically, we are concerned that otherwise qualifying elective payment projects may be overwhelmed by procedures outlined in draft guidance that would require tracking costs and country of origin for project components and subcomponents. This would essentially require project owners to convince suppliers to provide such proprietary information.

In May 2024, Treasury and the IRS expanded on this guidance, keeping the underlying regime, but also providing a safe harbor effectively allowing 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.

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. Additionally, Treasury guidance appears to indicate that public power utilities may join a partnership formed to own generation and transfer any production tax credits resulting from the energy property. While such credits would likely be sold at a discount – roughly 90 cents on the dollar is the current going rate – the property would not need to meet domestic content requirements for the credits to be transferable.

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

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.

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 have begun setting 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 – including IRA provisions. As part of this process, some continue to advocate for the wholesale repeal of the IRA, but a more studied approach is 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.

APPA Contact

John Godfrey, Senior Government Relations Director, 202-467-2929 / jgodfrey@publicpower.org

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.