Inflation Reduction Act of 2022: New Incentives for State and Local Government Clean Energy Infrastructure Projects

Direct Payments for Clean Energy Projects. Prior to the enactment of the Inflation Reduction Act of 2022 (Pub. L. 117-169) (the "IRA"), state and local governments did not have access to various federal tax credits available for clean energy projects, as these tax credits could only be utilized by entities that pay federal income taxes. A key provision in the IRA makes state, local governments, 501(c)(3) nonprofit organizations, tribal governments and other tax-exempt entities ("tax-exempt entities") eligible to receive a number of clean energy federal tax credits as direct payments. Other provisions allow tax-exempt entities to combine direct payments with tax-exempt bonds to fund clean energy infrastructure projects, with a relatively minor (15%) reduction in the direct payment. Local governments and other tax-exempt entities considering clean energy infrastructure projects may wish to compare the range of financing options now available for these projects to determine which option provides the deepest federal subsidy: (1) tax-exempt financing, (2) federal direct payments at the 100% level, or (3) tax-exempt financing combined with federal direct payments at the 85% level.

The IRA authorizes direct payments in lieu of tax credits to incentivize a range of clean energy investments. An "applicable entity" making an election with respect to any applicable credit is treated as making a tax payment for the taxable year with respect to which the credit was determined equal to the amount of such credit. Applicable entities include states and political subdivisions, tax-exempt organizations, tribal governments, and rural electric cooperatives. Tax-exempt entities may elect to receive "applicable credits" as defined in Section 6417(b), which was added to the Internal Revenue Code (the "Code")[1] as part of the IRA, as direct payments. In essence, the IRA allows tax-exempt entities to claim a refund for taxes they are deemed to have paid.

Some of the categories of applicable investment and production credits are described below.

Investment Tax Credits. An investment tax credit ("ITC") is a one-time tax credit based on the cost of the investment and is earned when the project is placed in service. The IRA expands the ITC programs available for qualifying investments in wind, solar, energy storage, and other renewable energy projects. The ITC rate may be increased for projects that meet prevailing wage and qualified apprentice standards, projects that meet domestic content requirements (for steel, iron, or manufactured components of the facility), projects in low-income communities, projects that are part of a qualified low-income residential building project or a qualified low-income economic benefit project, and projects in "energy communities." Energy communities include brownfield sites and areas dependent on coal, oil or natural gas. Projects generally may not claim a double benefit and are limited to receiving a single type of ITC described below.

- Energy (Section 48) ITCs are available for investments in specified energy property including solar, geothermal electricity, qualified fuel cell, qualified microturbine, combined heat and power system, qualified small wind energy, geothermal heat pump systems, waste energy recovery, energy storage technology, qualified biogasz and microgrid controllers. The ITC is

[1] All section references are to the Code, as amended by the IRA.

calculated as a percentage of the basis of the energy property placed in service during the tax year. This technology-specific tax credit sunsets (construction of eligible projects must begin prior to January 1, 2025), and is replaced with the technology-neutral, emissions-based clean electricity credit listed next.

- Clean Electricity (Section 48E) ITCs apply to certain electrical generation facilities for which the anticipated greenhouse gas emissions rate is not greater than zero and to energy storage technology. The facilities must be placed in service after December 31, 2024. The IRA phases out the credit one year after the later of: (i) December 31, 2032, or (ii) the year in which U.S. annual greenhouse gas emissions from electricity production are less than 25% of the 2022 emission rate.
- Advanced Energy Project Credit (Section 48C) provides a tax credit to qualifying manufacturing facilities for investment in new or upgraded industrial or manufacturing facilities to produce or recycle qualifying renewable energy projects. The IRA expanded the projects that are eligible for the Advanced Energy Project Tax Credit and increased the available credits to $10 billion. The IRS will allocate the credits to qualifying projects, with at least $4 billion reserved for projects located in energy communities.
- Alternative Fuel Refueling Property Credit (Section 30C). This credit is available to help finance fueling equipment for electricity, natural gas and other alternative fuels, providing a tax credit equal to up to 30% of the cost of the property. Eligible fueling equipment must be installed in locations that meet the following census tract requirements:
    - The census tract is not an urban area;
    - A population census tract where the poverty rate is at least 20%; or
    - Metropolitan and non-metropolitan area census tract where the median family income is less than 80% of the state medium family income level.

  This program may be a helpful tool for entities installing electric vehicle charging stations in low-income or rural areas. The credit is available to facilities placed in service through December 31, 2032.
- Credit for Qualified Commercial Clean Vehicles (Section 45W). This program provides a subsidy for "qualified commercial clean vehicles," capped at $40,000 for vehicles weighing 14,000 lbs or more and $7,500 for vehicles weighing under 14,000 lbs. The subsidy may be a helpful tool for cities, counties, fire districts, transit districts and others implementing programs to electrify police cars, fire trucks, school buses, and other vehicle fleets. The provisions expire on December 31, 2032.

Production Tax Credits. A production tax credit ("PTC") is a subsidy provided over time based on the electricity generated by the facility. PTCs may generally be claimed over a 10 year period, subject to earlier phase out provisions. Similar to the ITC adjustments described above, the IRA adds bonuses to the calculation of the renewable electricity PTC for projects that meet prevailing wage and qualified apprentice requirements, that meet domestic content requirements, or that are located in applicable energy communities. Projects generally may not claim a double benefit and are limited to receiving a single type of PTC described below. For some projects, issuers may elect to receive an up-front ITC in lieu of the corresponding annual PTCs.

- Renewable Electricity (Section 45) PTCs are available with respect to electricity generated by qualified facilities using qualified energy resources, including wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy, and sold to an unrelated person during the taxable year. Tax-exempt entities can claim direct payments in lieu of renewable electricity PTCs for qualified facilities that are originally placed in service after December 31, 2022, and qualified facilities generally must be placed in service (or, in some cases, construction on the facility must commence) before January 1, 2025. This technology-specific tax credit sunsets, and is replaced with the technology-neutral, emissions-based clean electricity credit listed next.
- Clean Electricity (Section 45Y) PTCs are available with respect to electrical generation facilities for which the greenhouse gas emissions rate (as defined in Section 45Y) is not greater than zero. Qualified facilities, which includes new units or additions of capacity, must be placed in service after December 31, 2024. In contrast to the renewable energy PTC under Section 45, the energy generated is not required to be sold to an unrelated person, but may be sold, consumed, or stored by the taxpayer if metered by an unrelated person. The IRA phases out the credit one year after the later of: (i) December 31, 2032, or (ii) the year in which U.S. annual greenhouse gas emissions from electricity production are less than 25% of the 2022 emission rate.
- Credits for Carbon Oxide Sequestration (Section 45Q) attributable to carbon capture equipment were extended and significantly increased by the IRA. The increased credits apply to facilities placed into service after December 31, 2022, and for which construction commences prior to January 1, 2033, and can be claimed for 12 years after the carbon capture equipment is placed in service.
- Production of Clean Hydrogen (Section 45V) credits are attributable to clean hydrogen production facilities owned by the taxpayer, which produce qualified clean hydrogen, and the construction of which begins before January 1, 2033 (which may include certain modification to existing facilities). "Qualified clean hydrogen" means hydrogen which is produced through a process that results in a lifecycle greenhouse gas emissions rate of not greater than 4 kilograms of CO2e per kilogram of hydrogen, which is produced in the United States in the ordinary course of a trade or business of the taxpayer for sale or use, and the production and sale or use of such hydrogen is verified by an unrelated party.
- Advanced Manufacturing Production Credit (Section 45X) provides a tax credit for eligible components of clean energy equipment produced in the United States and sold by a manufacturer to an unrelated person. Credits are available on an annual basis for eligible components sold in 2023 through 2032, with a phaseout beginning in 2030.
- Clean Fuel Production Credit (Section 45Z), applicable to clean transportation fuel produced and sold between December 31, 2024 and December 31, 2027.

Allocable Deduction for Energy Efficiencies. In addition to the provisions allowing direct payments in lieu of various clean energy tax credits, the IRA also includes incentives for including or installing energy-efficient components (such as energy efficient windows, HVAC, hot water and lighting features) in affordable housing and other buildings. The IRA expands the deduction under Section 179D of the Code to allow tax-exempt entities (including state or political subdivisions, or any agency or instrumentality of the foregoing) that include energy efficiencies in buildings owned by or on property owned by the tax-

exempt entity to allocate the deduction to the entity primarily responsible for designing the property. The IRA also increases the deduction amount (up to $5.00 per square foot if prevailing wage and qualified apprenticeship requirements are satisfied). With these amendments, the IRS provides an opportunity for local governments and other tax-exempt entities to allocate tax deductions to the designer (such as the architect, engineer or design-build contractor) and receive economic benefits in return for the allocation. The amendments are effective for buildings placed in service beginning January 1, 2023.

Next Steps. On January 9, 2023, the White House released an updated guide to the clean energy tax incentives in the IRA as well as the IRA's grant and loan programs. States and municipalities are eligible recipients for a number of these grant and loan programs, including for clean heavy-duty vehicles, qualifying port equipment and technology, neighborhood access and equity, adoption of updated building energy codes, climate pollution reduction strategies, and a number of other clean energy and climate initiatives. Additional program information will become available as the designated funding agencies complete requests for information and program development.[i] In terms of next steps regarding the IRA's tax incentives, on October 5, 2022, the IRS issued proposed notices requesting comment. Comments were due November 4, 2022, and guidance is expected in early 2023. The guidance may be helpful as state and local governments and other tax-exempt entities consider and compare the various incentive programs. If you have questions regarding these incentives, and how they can be combined with tax-exempt financing, please contact any of our public finance or federal grant program attorneys.

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[i] For example, EPA (https://www.epa.gov/inflation-reduction-act).

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