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Understanding the Inflation Reduction Act

The IRA's Clean Energy Tax Credit Direct Pay option impacts state, local government, higher education, school districts, and other tax-exempt entities.
Published: August 2023

On August 16, 2022, President Biden signed the Inflation Reduction Act (IRA) (H.R.5376). The IRA will put 386 billion dollars into climate and energy programs, including renewable energy, battery storage, and electric vehicles. This legislation will have a significant impact on the environment, U.S. manufacturing, and job creation.

Traditionally, school district and local government budgets are stretched as energy prices rise. This leaves little to no budget to invest in decarbonization, an initiative many communities are planning for and which will save money over the long term. The IRA provides financial incentives through tax credits for an array of renewable technologies to enable school districts, higher education, and local governments to accelerate their decarbonization and Net-Zero initiatives while potentially reducing costs over the life of the improvements. Perhaps one of the most significant changes is the option for Direct Pay to non-profits and tax-exempt entities, which, for the first time, allows them to finally take advantage of renewable tax credits.

Airports, industrial and commercial properties have not been forgotten. The IRA includes revised tax incentives for projects over 1MW and a Production Tax Credit for utility cooperatives looking to add renewables and storage to their portfolios.

While the final rules have not yet been released, the Treasury Department has released temporary proposed rules that define the program and how it will be administered and outlined how to claim these tax credits, even for organizations that don't typically pay taxes or file for returns.

Investment Tax Credits

The IRA updates and replaces the current Investment Tax Credits (ITC) system, slated to expire this year, with a new, more generous credit. Previously, the ITC was a flat 26% and was only applicable to non-tax-exempt entities. The new ITC has been increased to 30% for all projects under 1MW and larger projects that meet specific wage and apprenticeship requirements. Additionally, the IRA creates a mechanism for certain "adders" that theoretically could result in a full 70% credit. Consultation with qualified renewable installers is highly recommended to determine your organization's possible adders. There is also an opportunity to transfer these credits to taxpaying entities, allowing for potentially offsetting project costs at the start rather than waiting for a tax refund after the project has been actualized.

Production Tax Credits

The new Production Tax Credits (PTC) are similar to the ITCs in that the IRA extends and replaces current laws to make the credits more enticing, including non-profits and tax-exempt entities. However, instead of a flat percentage, the credit is based on the actual energy production of the installed system. For a PTC, an organization receives between 1.3 to 2.6 cents per kWh if they qualify for additional credits by meeting the same adder requirements as the ITC.

NEW Direct Pay

The direct pay provision will significantly impact how tax-exempt entities can monetize the investment tax credits and, in turn, how clean energy projects will be financed going forward. Previously, only taxpaying entities could take advantage of federal tax credits for renewable energy. Tax-exempt entities, such as state and local government, higher education, school districts, Indian tribes, and rural electrical cooperatives, could not directly benefit from tax credits for such projects. For the first time in history, the playing field is level. Direct payments in place of tax credits open the door for projects to be owned by our clients.

The direct payment applies only to tax years beginning after December 31, 2022, and requires a selection on the tax form to receive the credit, generally on the tax return filed in the year the project is placed in service. For tax-exempt entities that do not file tax returns, the treasury has yet to issue final rules, but have they issued proposed guidelines for how the process should work. They have designed it to be very simple, consisting of only 5 steps and utilizing existing tax forms to streamline the process. They anticipate that files will receive their rebates in the tax year immediately following when the project comes online.

Next Steps

Solar and other renewable feasibility and sitting (location) can take between one to three months. The time to start planning is immediate. Many companies offer specific renewable energy services; however, a company that reviews your goals and offers an analysis of your current infrastructure and assists in determining the best methods for a short- or long-term strategy for implementation, such as Veregy, is the most desirable company to work with. Veregy's distributed energy resource developers and engineers will holistically evaluate renewable energy and battery storage feasibility. They will consider all factors that affect the cost, feasibility, synergies, and operation of various systems to maximize the investment tax credit. They will gather, review, and confirm technical information and identify all necessary information to get started. After an energy audit, Veregy evaluates the provisions a facility qualifies for, including the prevailing wage, domestic content, apprenticeship program, low-income, and energy community requirements, and consults with their staff to move forward with the tax incentive process.

Other Notable IRA Financial Allocations

Greenhouse Gas Reduction

$29 billion, of which $7 billion is allocated for competitive grants, loans, and other financial assistance for low-income and disadvantaged communities for Zero-emission technologies and distributed energy.

Climate Pollution Reduction

$5 billion was allocated for grants to state and local governments.

Diesel Emissions Reductions

$60 million through September 30, 2024, to reduce diesel emissions in low-income and disadvantaged communities.

Funding to Address Air Pollution at Schools

$37.5 million in grants and "other activities" through September 30, 2031, to monitor and reduce greenhouse gas emissions and other air pollutants at schools in low-income and disadvantaged communities.

Clean Fuel and Vehicle Tax Credits

$36 billion in commercial EV tax credits.

Stay Informed

To aid in understanding the latest IRA information, Veregy's distributed energy subject matter experts will continue to monitor the IRA over the next 180 days as details on provisions are announced and communicate these updates promptly. Learn more on Veregy's Federal Funding page: https://veregy.com/federal-funding/.

References

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2. https://www.congress.gov/bill/117th-congress/house-bill/5376
3. https://www.seia.org/