LAWYERS FOR GOOD GOVERNMENT

Mechanics and Opportunities of Elective Pay

IRA Elective Pay Learning Session

SSDN 2024 Annual Meeting, May 1, 2024

Agenda

1. Opening Remarks / Intros
2. What is Direct Pay?
3. Bonus Incentive Adders
4. How Does it Work?
5. Practical Considerations for Cities
6. Is it Worth It?
7. Resources

This Presentation Is Not Legal Advice

Today's discussion provides a high-level overview only and should not be considered direct legal advice. Please consult your in-house attorney and your finance officer about your specific matter.

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Elective Pay 101 (a.k.a. "Direct Pay")

- **What is Direct Pay?**
  - For the first time ever, Direct Pay gives tax-exempt eligible entities (i.e. states, local governments, nonprofits) the ability to receive direct payments from the IRS for clean energy tax credits by filing tax forms

- **Brand new source of funding for nonprofits, CBOs, states, local governments, tribes, etc. to be reimbursed for creating new renewable energy projects, like:**
  - Investing in and constructing clean energy (community solar)
  - Placement of EV infrastructure in rural, urban and low income
  - Rooftop solar

- **No competition; potentially limitless source of funding for clean energy projects in communities**

- **Reimbursement of 30%, 40%, potentially 70% cost of the project**

Parties Eligible for Direct Pay

- CBOs, Nonprofits, Religious Institutions, Other Tax-Exempt Entities
- States and local governments, other instrumentalities (public schools, libraries)
- Must own the asset**
- Territories, agencies, & instrumentalities
- Municipally-owned utilities
- Indian tribal governments
- Alaska Native Corporations
- Tennessee Valley Authority
- Rural electric coops

Parties Excluded from Direct Pay

- Partnerships**
- Private Taxpayers

Tax Credits Eligible for Direct Pay

Section 30C Alternative fuel refueling property	Section 45 Renewable electricity production tax credit (PTC)	Section 45Q Carbon dioxide sequestration credit	Section 45U Zero-emission nuclear power production credit
Section 45V Clean hydrogen production credit	Section 45X Advanced manufacturing production credit	Section 45Y Clean electricity production credit	Section 45Z Clean fuel production credit
Section 48 Energy investment tax credit (ITC)	Section 48C Qualifying advanced energy project credit	Section 48E Clean electricity investment credit	Section 45W Qualified commercial vehicles

Tax Credits & Projects Most Relevant to Local Governments

Example Projects:
EV Infrastructure Placement in non-urban or low income areas

Section 30C
Alternative fuel refueling property

Section 45
Renewable electricity production tax credit (PTC)

Example Projects:

- Microgrid/ Community Solar
- Storage deployed at distribution level
- Port electrification

Example Projects:
EV Fleet Transition

- Gov. vehicles, school buses, public transit, etc.
- Stacking available with EPA funding

Section 45W
Qualified commercial vehicles

Section 48
Energy investment tax credit (ITC)

- Rooftop Solar or Wind on gov. buildings or affordable housing
- Geothermal HVAC

***Important Role for Munis: Educate & Provide Resources for Nonprofits and Communities**

Avoid Pitfalls: Energy Efficiency Upgrades Are Not Eligible for Direct Pay

Issue: HOMES (Home Efficiency Rebates) and HEEHRA (High Efficiency Electric Rebate Act) provide significant funding to rehabilitate low income homes. Many cities believe that these efficiency upgrades are eligible for tax credits using direct pay in connection with 179D.

Unfortunately, the IRS did not make 179D efficiency upgrades eligible for Direct Pay.

179D: The 179D commercial buildings energy efficiency ***tax deduction*** primarily enables building owners to claim a tax deduction for installing qualifying systems in buildings. Tenants may be eligible if they make construction expenditures.

BUT, 179D is available to Architects, Engineers, and Contractors - consider negotiating into contracts for reduced costs.

Additional Bonus Adders

"Layering"

Four Main Bonus Incentives to Remember

1. **Domestic Content:** Can be a (+) (add 10%) or a (-) ('haircut' starts in 2024)

2. **Prevailing Wage and Apprenticeship (PWA):** Only a (-); must meet to keep 30%

3. **Energy Communities:** (+) Adds 10%

4. **Low Income Communities Bonus (LICB):** (+) Can add 10-20% depending on who benefits and where it's located

Three Questions to Ask About Incentive

- **Does it apply to my project?**
- **Does it add or subtract?**
- **How do I comply?**
    - Does it require a separate application?
    - Are there exemptions or waivers?

Domestic Content (DC)

Does It Apply to My Project?

- Only applies to clean energy projects: Investment Tax Credit (**ITC**) or Production Tax Credit (**PTC**) that are **> 1MW** in size *(Ex: Solar/Wind)*
- Does *NOT* apply to EV purchases or EV infrastructure

Does It Add Or Subtract? Both

- **Add:** If DC applies and you comply = 10% increase in overall taxable basis or PTC rate
- **Subtract:** If DC applies and you don't comply = a "**domestic content haircut**" starts in 2024:
  - Start of construction in 2024: Only 90% (of 30% total)
  - Start of construction in 2025: Only 85% if construction begins in 2025
  - Start of construction in 2026: NO DIRECT PAY = Big Loss

Definition: *Start of Construction*

- If entity pays or incurs ≥ 5% of the total facility cost
- If "significant work" has started - Start of physical work

Domestic Content (continued)

How Do I Comply?

- **Two Parts to Domestic Content - both required to receive bonus and avoid "haircut"**
    - **Part 1: Iron and Steel:** 100% must be produced in the U.S. - Structural in function
    - **Part 2: Manufactured Product (applicable share):**
        - 40% of total cost of all "manufactured products" must be produced in the United States
        - Required percentage increases over 3 years to 55%
        - Required percentage starts at 20% for offshore wind projects

Domestic Content (continued)

Statutory Exception is available:

- **Increased Cost Exception: If** DC requirements increase total project costs of construction by > 25%**, OR**
- **Non-Availability Exception: If** the required materials are not produced in the U.S. in sufficient and reasonably available quantity OR of a satisfactory quality

Draft Rules/Awaiting Final:

- Proposed Rules (Dec 2023) asked for input on factors to be considered in approving exceptions
- Additional guidance on requesting waivers is expected (won't need until filing for 2024 projects)
- IRS is considering what information should be necessary to grant an exemption for eligible entities

Reminders:

- Does NOT apply to EV fleet transition, EV charging, hydrogen, carbon capture, etc. **Only ITC/ PTC > 1MW**

Prevailing Wage & Apprenticeship (PWA)

Does It Apply To My Project? Applies to: **ITC (sections 48 and 48E), PTC (sections 45, 45Y),** Advanced Energy Project Credit (section 48C), **Alternative Fuel Vehicle Refueling Property (EV Infrastructure, section 30C),** Carbon Capture (section 45Q), Zero-emission Nuclear Power (section 45U), Clean Hydrogen (section 45V), and the Clean Fuel Production Credit (section 45Z)

Does It Add Or Subtract? Subtract Only (though described as an adder)

- If it applies and you don't comply: Base rate = 6% for ITC or 0.5 cents/kWh (adjusted for inflation) for PTC
- If you do comply: Back up to 30%

How Do I Comply?

- Prevailing wage: Must pay prevailing wage based on a survey of pay across any given industry; floor for compensation. See DOL's FAQ for more information.
- Apprenticeship: Apprenticeship programs are registered with the DOL office; minimum of 15% apprenticeship hours on the entirety of the construction
- Requirements apply to **construction, alteration, and repair**

Prevailing Wage & Apprenticeship (continued)

Exceptions for ITC/PTC: PWA Requirements do NOT apply to ITC/PTC (48, 48E, 45, 45Y) that are less than 1MW.

Exceptions for all other credits (including EVSE) (30C, 48C, 45Q, 45U, 45V, 45Z): PWA Requirements do NOT apply if the project **started construction** before January 29, 2023.

Documentation: Must maintain records that are sufficient to establish that the entity and the entity's contractor and subcontractor paid prevailing wage.

Types of Records:

- Documentation identifying the applicable wage determination
- The laborers and mechanics who performed construction work on the facility
- The classifications of work laborers and mechanics performed
- The hours worked by laborers and mechanics in each classification
- The wage rates paid for the work

Domestic Content/PWA Practical Guidance

Domestic Content is biggest issue for large scale (>1MW) solar/wind starting in 2025 and beyond:

- Include Domestic Content & PWA Requirements in RFP Bid Package for ITC/PTC Projects
- Understand your project cost breakdowns and which components will drive compliance (e.g., solar panels often comprise the significant majority or plurality of overall project cost)

Ways to Mitigate Risk

- Domestic Content is not an issue for Fleet Transition/EV Infrastructure
- EVSE - started construction before Jan 2023 - no PWA
- Obtain tax liability insurance
- Ensure vendors provide adequate documentation on direct cost data to substantiate required attestations to IRS
- **Push liability onto contractor:** Involve your legal and tax counsel early to update procurement forms, and other contracts to incorporate appropriate representations and indemnities and bonus credit compliance information (e.g., domestic content); properly value your tax credit basis.

Energy Communities Bonus: +10%

Does It Apply To My Project?

ITC/PTC projects located in "energy communities" are eligible. IRS defines energy communities as:

1. A "brownfield site"
2. Area employed by coal, oil, or natural gas and unemployment rate above national average
3. A census tract in which coal mine closed after 1999 or coal-fired power plant has been retired after 2009

Use the **WRI Bonus Mapper** to confirm eligibility for Energy Communities, J40, LICB.
Use the **EnergyCommunities.gov** FAQs to confirm eligibility **including brownfields.**

Does It Add Or Subtract?

- ADD **10% increase** to the **PTC**
- ADD **10 percentage point increase** to the **ITC**

How Do I Comply?

- If it applies (ITC/PTC) and you're within an Energy Community, you comply!

Low Income Communities Bonus (LICB)

Does It Apply To My Project?

- Only applies to ITC projects (max net output <5MW)
- Must fit one of four categories:
  - Category 1, 10%: Located in a low-income community
  - Category 2, 10%: Located on Indian land
  - Category 3, 20%: Low-income residential building project (affordable housing programs)
  - Category 4, 20%: Low-income benefit project (financial benefits to low-income/Affordable Housing)

Does It Add/Subtract?

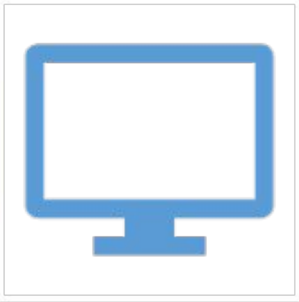
- ADDS **10-20%**, depending on categories above

How Do I Comply/Apply?

- Separate application process required → receive a capacity allocation → place "in service" to claim LICB adder
  - See the DOE LICB Dashboard and L4GG's LICB Fact Sheet for more info
- Allocation process can take time - Apply BEFORE YOUR PROJECT IS COMPLETED!
- **If no allocation, no addition to bonus!**

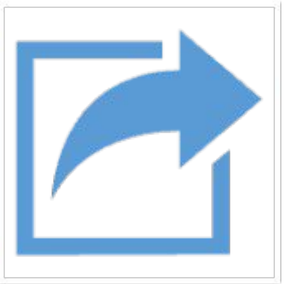
How it Works: Filing Process

Direct Pay: Mechanics & Process



Pre-Filing Registration

- Register each unique project for which tax credit will be claimed via IRS website
- Get unique registration number



IRS Filings

- File tax return (Form 990-T) & Form 3800 with registration numbers and supporting documentation by tax deadline
- Due 4.5 months after end of taxable year (+6-month extension if requested)

Receive Funds

- IRS makes payment after review of tax filing
- Likely more than 1 year after project is placed into service/money is spent

Overview of the Direct Pay Process

1. **Identify** qualifying projects for 2023 and start planning 2024+ projects with Direct Pay in capital stack
2. **Build internal team:** Work with financial officers (CFO) and in house counsel to identify eligible credits, authorized party, etc.
3. **Timeline:** Identify taxable year project was placed in service - 2023? 2024?
4. **Pre-Filing Registration portal:** Use the **IRS Pre-Filing Registration tool** to obtain Unique Registration Number for each "applicable credit property"
5. **File tax forms**: 4.5 months after end of taxable year, or 10.5 months with an extension
6. **Get paid:** Receive payment after the return is processed (no clear timeline; financial institutions estimate 12+ months)

Necessary Documentation

- **Ownership:** Purchase Agreement, Invoices, Receipts, Summaries of Ownership, EV title, etc.
- **DC/PWA:**
    - Documentation identifying the applicable wage determination; The laborers and mechanics who performed construction work on the facility; The classifications of work laborers and mechanics performed; The hours worked by laborers and mechanics in each classification; The wage rates paid for the work
    - Proposed rule waiting on final rule - for now, include this requirement in bid package and push risk onto contractor.
- **Energy Communities**: Use DOE Map
- **LICB:** Separate application process required
    - Apply for LICB allocation PRIOR to project
    - Use info from successful LICB allocation to complete pre-filing registration

Practical Considerations

Practical Guidance: Municipal Capacity

- **What was your city's experience with the State and Local Fiscal Recovery Funds from the American Rescue Plan Act?**
    - Find the finance officer who handled this process and it will streamline your process!

- **People you NEED to talk to:**
    - In-House Counsel: to support outside legal help from L4GG or others, identify any necessary internal approvals that may be required to receive funds, attestations, etc.
    - Financial Officer: ID.me account, work with tax forms, accounting for project costs/financing

- **What other expertise might be needed? To name a few...**
    - Accountant
    - Bond counsel
    - For larger projects, an attorney specializing in tax/project finance

- **How Are You Paying for Your Project?**
    - Municipal bonds for ITC will reduce amount by 15%
    - Restricted grants and forgivable loans count against project cost - No Excess Benefit

Practical Guidance: Municipal Capacity

Questions about risk:

- **Do you understand the risks associated with the tax code?**
  - Reductions in Direct Pay from tax-exempt bonds
  - Recapture: excess payment + 20% penalty

- **Safe harbor provisions**

- **How do you mitigate this risk?**
  - Tax liability insurance
  - Appropriate representations, indemnities, and documentation of bonus credits

Takeaway: Elective pay is a huge opportunity to advance clean energy. IRS rules are complex. Municipalities will need to spend time and resources building up internal capabilities, or will need to find an outside partner to manage this process for them.

Practical Guidance: Is Elective Pay worth pursuing?

I.e. “Is the juice worth the squeeze?”

- Elective pay is non-competitive - it is *not like most grants* and we shouldn’t think of the work involved in the same way
  - No scoping
  - Certainty
  - No post-credit reporting
- Resources and assistance are available from groups here and others
- You likely will use Elective Pay, and it’s better to learn it now
  - 10-year program
  - The only funding like it

Bringing it All Together

Photo Credit: Solar Builder

You can do this!

- Two-step process with IRS
  - Pre-filing registration portal
  - Elective pay filing
- Planning for direct pay should begin early in project

Putting the puzzle pieces together:

- What credits are being used?
- Are there eligibility restrictions or bonus credits that have specific criteria?
- What funding pieces am I using, and do they impact project cost basis?

Photo Credit: City of Columbus, OH

Q&A