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## **Inflation Reduction Act Brings Big Changes to Clean Energy Tax Incentives**

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Over the next decade, the United States, through enactment of the Inflation Reduction Act of 2022 (IRA), is primed to make a \$369 billion investment in clean energy and climate change programs. The lion's share of this investment comes in the form of tax credits (extending or expanding existing tax credits, reinstating expired tax credits, and establishing new tax credits) to incentivize behavior that makes significant progress in reducing greenhouse gas (GHG) emissions (with projections showing a nearly 40% decrease in GHG emissions compared to a 2005 baseline) while at the same time encouraging domestic manufacture of key climate change technologies.

Companies looking to execute projects to take advantage of these tax credits should note two significant differences from how these types of tax credits have been provided in the past.

First, with limited exceptions, most credits are set up with a low "base" credit that can be increased by satisfying certain requirements. For example, the investment tax credit has a "base" credit amount of 6%, which can be increased to 30% if the project meets both a prevailing wages requirement for its laborers, mechanics, contractors, and subcontractors and an apprenticeship labor requirement that a certain percentage of the total labor hours for construction, alteration, or repair work on a project are performed by qualified apprentices. The credit can be increased even further by satisfying a domestic content requirement, locating the facility in an "energy community" (which includes brownfields, areas with a history of significant fossil fuel employment, and properties on which a coal mine or coal-fired electricity generation has been recently located), or locating smaller scale projects in low-income communities or on Indian land. Similarly, some credits contain an enhanced credit for using certain technologies in project execution (e.g., the carbon oxide sequestration tax credit is enhanced for projects using direct air capture).

Second, and a change that is poised to shake up how certain projects are financed and developed, new methods of monetizing tax credits have been added. For developers, the ability to transfer all or a portion of eligible credits to an unrelated third party provided in exchange for cash consideration (which consideration is not included in the transferee's gross income nor deductible by the transferor) will be fairly significant in how a project is structured (even if projects may still need a tax equity component to monetize accelerated depreciation). The IRA will also help incentivize certain tax-exempt and government entities to execute projects by offering direct payment in lieu of certain tax credits. For-profit entities pursuing clean hydrogen production, carbon capture and sequestration, and domestic advanced manufacturing projects can also elect direct pay in lieu of tax credits for those types of projects. We expect direct payment to drive significant activity towards those types of projects. Ultimately, new ways of monetizing credits will give rise to several new transaction structures.

This update is intended to provide a high level overview of some of the IRA's tax credit incentives targeting clean energy and climate change. We have also published separate updates regarding the Act's [energy storage incentives](#) and a [general overview of IRA incentives](#).

### **Production Tax Credit and Investment Tax Credit**

Recognizing that clean energy and climate change technology is a rapidly developing field, the IRA transitions the Investment Tax Credit (ITC) and the Production Tax Credit (PTC) to technology-neutral (indifferent to the method of producing electricity as long as it produces zero GHG emissions) for projects that begin construction after December 31, 2024. In contrast, the existing ITC and the existing PTC, are both technology-specific in that only certain types of projects qualify. The benefit of a technology-neutral approach is that it avoids the need for congressional action to make new zero-emission electricity generating technologies eligible for tax credits as they emerge. It also keeps all technologies on the same timeline for expiration of credits (in the past PTC credits for different technologies have expired and not been renewed due to congressional inaction or phased down at different points in time).

The existing technology-specific ITC and PTC will continue to apply to projects that begin construction prior to January 1, 2025. Consistent with Congress's intent to adapt a technology-neutral standard going forward, certain project types that were scheduled for phase down or previously ineligible will now be able to receive full ITC or PTC credits (e.g., energy storage, qualified biogas property, and microgrid controllers are now eligible for the existing ITC and the January 1, 2022 phase down for wind facility PTC eligibility has been removed, etc.). Additionally, interconnection costs can now be included in the ITC basis for the purpose of calculating the credit. The IRA also creates several new types of production credits, including, (1) a new zero-emissions nuclear credit for facilities previously placed in service that have not received the Advanced Nuclear Production tax credit, (2) a new clean hydrogen production tax credit equal to up to \$0.60 per kg (increased to \$3.00 per kg for projects satisfying prevailing wage and apprenticeship requirements) for qualified clean hydrogen meeting certain lifecycle GHG emission requirements, and (3) a sustainable aviation fuel credit for each gallon of sustainable aviation fuel sold or used before December 31, 2024.

Significantly, solar is once again PTC-eligible (the solar PTC expired in 2005 and was not renewed until the IRA). In most instances, when a project type is eligible for both the ITC and the PTC, projects elect to use the PTC (because the PTC's \$/kWh credit for energy produced and sold claimed over a 10-year window from the placed in service date creates more value over the long run than the ITC's % of basis credit). With solar projects able to choose between the PTC and ITC, we expect to see many larger-scale solar projects electing the PTC going forward to receive tax credits based on the volume of energy they will produce over the ten year window.

The IRA has strong labor components and we expect to see projects electing to pay prevailing wage and meet apprenticeship labor requirements to maximize tax credits given that the "base" tax credit is set at such a low value. However, the prevailing wage and apprenticeship requirements will be deemed satisfied for projects that can begin construction prior to (or within 60 days after) the Treasury or IRS releases

guidance on those requirement. Therefore, projects that are near-ready to move to construction should be incentivized to move quickly to begin construction prior to the issuance of such guidance.

### **Carbon Capture and Sequestration Credits**

The IRA allows for-profit entities to receive direct pay in lieu of a tax credit for installation of carbon capturing equipment for five years after the carbon capture equipment is placed into service. Additionally, the IRA increases credit values for any capture equipment placed in service after December 31, 2022. Similar to the PTC and ITC, in order to maximize credits, a project needs to pay prevailing wage and meet apprenticeship labor requirements. The amount paid varies based on the capture/sequestration method. For example, direct air capture can pay up \$180/metric ton for sequestration and \$130/metric ton for use in enhanced oil recovery projects. Other capture technologies can pay a maximum of \$85/metric ton for sequestration and \$60/metric ton for enhanced oil recovery. The IRA also reduces the threshold of metric tons required to be captured to be eligible for the credit (as low as 1,000 metric tons per taxable year for direct air capture, 18,750 metric tons per taxable year for electric generating facilities, and 12,500 metric tons per taxable year for other facilities).

### **Incentives for Domestic Manufacture of Clean Energy Equipment and Technology**

To incentivize the domestic manufacture of key clean energy components, The IRA allows for-profit entities to either receive a tax credit or direct pay in lieu of a tax credit for the domestic manufacture and sale of certain clean energy materials, equipment, and technology to unrelated parties through the newly created Advanced Manufacturing Production Credit. The new credit, which will be phased out over four years after 2030 (with the exception of critical minerals), provides significant credits for thin film or crystalline photovoltaic cells, photovoltaic wafers, solar grade polysilicon, polymeric backsheet, solar modules, wind energy components (such as blades, nacelles, towers, and offshore wind foundations), torque tubes, structural fasteners, inverters, electrode active materials, battery cells, battery modules, and applicable critical minerals. For components manufactured in a facility governed by a collective bargaining agreement, the tax credit is increased by 10%. We expect this new credit to strongly incentivize domestic manufacturing.

The Advanced Energy Project Credit is also reinstated and expanded to provide the Treasury Secretary new authority to allocate \$10 billion in tax credits (of which \$4 billion is set aside for projects in energy communities) to investments in projects that reequip, expand, or establish qualified energy manufacturing facilities. Similar to the ITC, the base credit is set at 6% but allows a 30% credit for projects that meet prevailing wage and apprenticeship labor requirements.

### **Consumer Tax Credits**

The IRA doesn't limit the tax credit benefits to investors, energy producers, and manufacturers. Indeed, recognizing how important consumer adoption of clean energy technology is for achieving GHG reductions, the IRA provides tax credits for clean vehicles and home installation of clean energy technologies. For example, the IRA provides a clean vehicle tax credit (\$4,000 to help lower/middle income individual buy used clean vehicles and up to \$7,500 for new clean vehicles). The IRA also extends the residential clean energy credit (which had been set to expire at the end of 2023) until 2034, which will

help consumers elect to install technologies such as solar photovoltaic, solar water heaters, geothermal wind pumps, small wind turbines, fuel cells, and battery storage technology at their residences through a non-refundable tax credit. The new home efficiency credit is also expanded and extended through 2032 to provide tax credits to taxpayers purchasing a new single-family homes meeting certain energy efficiency standards.

The IRA is a complex piece of legislation with many nuances. If you have any questions about tax credits available under the IRA please contact any of the authors listed below.



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