

# Understanding the Direct Pay Provisions in the Inflation Reduction Act

Cities across the United States are working to advance a clean energy transition, which is crucial to reducing carbon emissions and meeting climate goals. The federal government recently developed a new financial tool called Direct Pay (also called Elective Pay) to incentivize clean energy investments.

Enacted as part of the Inflation Reduction Act of 2022 (IRA), Direct Pay will provide direct financial assistance to cities, non-profit organizations, and other tax-exempt entities to defray the costs associated with clean energy investments, for example electrifying a city's fleet or installing solar panels on public buildings.

What's more, Direct Pay recipients can increase the value of their benefit by as much as 30% if their project supports low-income communities, communities traditionally dependent on coal, or if they abide by prevailing wage and apprenticeship requirements.

The bottom line is that Direct Pay has the potential to serve as a catalyst for movement towards a clean energy transition, as it will provide cities with unprecedented financial support for these projects.

## How Direct Pay Works

Historically, tax-exempt entities have not benefited from clean energy tax incentives because they do not owe federal income taxes. Direct Pay has changed this dynamic by providing cash payments equal to the value of the underlying tax incentive.<sup>1</sup>



When a for-profit entity uses a tax credit, it reduces the amount of taxes that they owe to the federal government. Tax-exempt entities like local governments have traditionally been unable to utilize these types of benefits because they owe nothing in federal taxes. But under Direct Pay, they are eligible for cash payments equal to the amount of money that would be reduced from their tax liability if they were not tax exempt.

These clean energy tax credits can serve as a catalyst for local governments to achieve renewable energy and carbon-neutrality goals. Importantly, cities can use Direct Pay benefits in tandem with federal or state funding sources – for example, grants under the Bipartisan Infrastructure Law (BIL) or IRA.

Additionally, the value of some of the tax credits eligible for Direct Pay increase based on whether certain criteria are met, for example if the project meets prevailing wage and apprenticeship requirements, [domestic content requirements](#), or if the project is located in an [energy community](#).

<sup>1</sup> The examples in this document are for illustrative purposes only. The tax rules surrounding these credits and the conditions on which direct payment is available are complex. This document should not be considered legal advice. Please seek the assistance of qualified legal counsel

## What Tax Benefits are Eligible for Direct Pay?

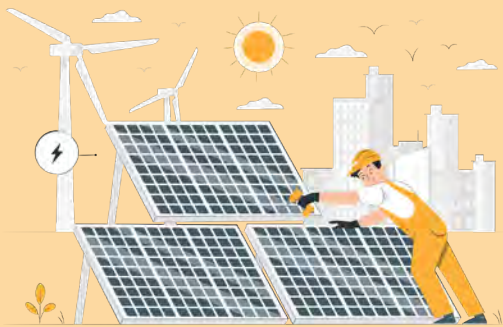
Direct Pay includes [12 tax credits](#) designed to promote clean energy investments and energy conservation. Listed below are the benefits that are most relevant to local governments:

**Tax Credits for Clean Vehicles** – to support electric vehicle (EV) charging and other forms of alternative fueling, as well as for the purchase of clean commercial vehicles, like EV buses.

- **Alternative Fuel Vehicle Refueling Property Credit:** The tax credit supports EV charging and other types of alternative fueling projects.
- **Credit for Qualified Commercial Clean Vehicles:** The tax credit supports the purchase of EVs.

**Tax Credits for Energy Generation** – to produce and invest in clean energy projects, including solar, wind, municipal solid waste, biomass, hydroelectric, and energy storage technologies.

- **Production Tax Credit (PTC):** The value of the tax credit is based upon how much energy the project generates.
- **Investment Tax Credit (ITC):** The value of the tax credit is tied to how much money is invested in the project.



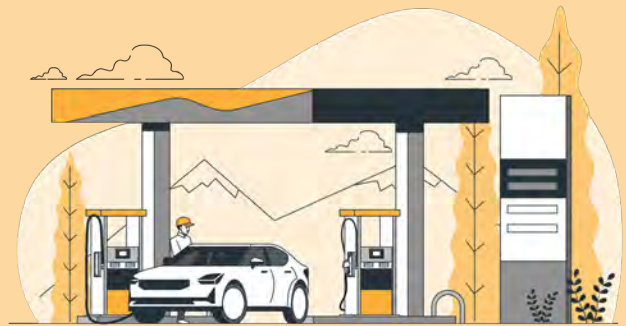
### Direct Pay in Action: Madison, WI

The City of Madison, WI has [identified](#) \$13 million in tax credits through Direct Pay to complement an array of planned or ongoing infrastructure projects.

[For example](#), the city plans to use the clean vehicle tax credits to fund electric grid upgrades that will support charging and fueling infrastructure for a newly electrified city fleet. The city will be using this tax benefit in tandem with a Low- and No-Emission and Bus and Bus Facilities grant under the Bipartisan Infrastructure Law.

The city is also allocating millions of dollars for energy efficiency upgrades at public buildings, including at a [shelter](#) for the unhoused.

See our case story for more details on [Madison's project](#).



### Direct Pay in Action: Denver, CO

In November 2020, Denver voters overwhelmingly approved a ballot measure to create the [Climate Protection Fund](#) (CPF) to raise approximately \$40M per year dedicated to climate action via a 0.25% local sales tax. Direct Pay will enable them to get rebates for their ongoing investments, which they intend to reinvest in furthering transitional efforts at city agencies and throughout the community.

Denver's sales tax is the financing mechanism that will provide the upfront funds for climate action projects eligible for Direct Pay. The CPF will invest in solar power, battery storage and sustainable transportation, support workforce development initiatives for the clean energy sector, advance neighborhood-based environmental and climate justice programs, improve resiliency programs for vulnerable communities, and upgrade the energy efficiency of residential, commercial, and industrial properties.

See our case story for more details on [Denver's approach to Direct Pay](#).

# Promoting Clean Energy Projects Through Direct Pay: A Resource for Cities

## Background

Under the Direct Pay provisions of the Inflation Reduction Act (IRA), cities, nonprofit organizations and other tax-exempt entities can for the first time utilize tax benefits for clean energy generation: the Production Tax Credit (PTC), and the Investment Tax Credit (ITC).

Eligible projects include those that generate energy from solar, wind, municipal solid waste, biomass, hydropower, and energy storage technologies. Notable examples include placing solar panels on public buildings, or construction of a wind farm. These two tax benefits are very similar, with the major difference being that the value of the PTC is based on the amount of energy produced by the project, whereas the value of the ITC is based on the dollar amount invested in the project.

- **Production Tax Credit (PTC):** The value of the tax credit is based upon how much energy the project generates for the first 10 years of operation.
- **Investment Tax Credit (ITC):** The value of the tax credit is tied to how much money is invested in the project in a tax year.

Note: The PTC and ITC currently restrict eligibility to [specific types](#) of projects, for example solar, wind, and biogas. This is going to change at the end of 2024, when the credits will become agnostic to the technology used to produce energy, and will be tied solely to the fact that the projects produce energy with zero greenhouse gas emissions

## Credit Amount and Bonuses

One of the most impactful elements of Direct Pay is that it includes several “bonuses” that recipients can receive if their projects meet certain criteria. These can increase the value of the credit by as much as 30%.<sup>6</sup> Bonus categories include:

- **Prevailing Wage and Apprenticeships:** The project pays no less than applicable [prevailing wage rates](#) and employs registered apprentices for a certain number of hours.
- **Domestic Content:** Steel, iron or manufactured products for the project are produced or manufactured in the United States. Note that in order to be eligible for this benefit, the beneficiary will have to complete a certification process by the date that the project is placed in service.
- **Energy Community:** The project is located in a [community](#) historically dependent fossil fuels, or on a [brownfield site](#). This bonus generally [increases](#) the value of the credit by 10%. See if your community qualifies [here](#).
- **Low-Income Community:** The project is located in a low-income, or high-poverty area. Note that cities and other eligible entities must [apply](#) to receive their bonus, which can increase the credit by between 10% and 20%.<sup>7</sup>

<sup>7</sup> The Low-Income Community bonus includes separate requirements for “low-income residential building” projects and “economic benefit” projects. For more details, refer to the [final guidance](#).

The tax credit amount varies by the Megawatts produced by the project or the investment required. The below table details the generosity of the tax benefits and bonuses:

Category	Amount for Projects less than 1MW <sup>AC</sup>	Amount for Projects greater than 1MW <sup>AC</sup>
Base Tax Credit	ITC: 30% PTC: 1.5¢/kWh (Indexed for inflation)	ITC: 6% PTC: 0.3¢/kWh (Indexed for inflation)
<b>Bonus Credit: Prevailing Wage and Apprenticeship (PWA) Requirements</b>	ITC: N/A PTC: N/A	ITC: Base x 5 (30%) PTC: Base x 5 (1.5¢/kWh)
<b>Bonus Credit: Domestic Content<sup>8</sup></b>	ITC: +2% or 10% (PWA) PTC: +0.3¢ or 0.15¢ (PWA) /kWh	ITC: + 2% or 10% (PWA) PTC: +0.3¢ or 0.15¢ (PWA) /kWh
<b>Bonus Credit: Energy Community</b>	ITC: +10% PTC: +0.3¢ or 0.15¢ (PWA) /kWh	ITC: +10% PTC: +0.3¢ or 0.15¢ (PWA) /kWh
<b>Bonus Credit: Allocation of Qualified Low-Income Community</b>	ITC: +10 or 20% <sup>9</sup> PTC: N/A	ITC: +10 or 20% PTC: N/A

## Example Projects:



City A will install solar panels on numerous municipally-owned buildings, including a fire station, police station, library and engineering service building.

<sup>8</sup> The amount of payment may be reduced if domestic content rules are not met. Thus, it can act as a bonus if met, and a haircut if unmet.

<sup>9</sup> The Low-Income Community bonus includes separate requirements for "low-income residential building" projects and "economic benefit" projects, which can affect the bonus amount. For more details, refer to the final guidance.

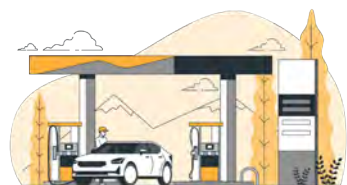
## Example Projects Continued:



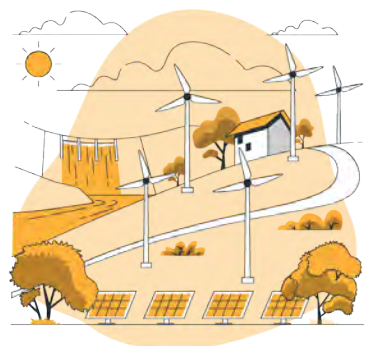
City B will own and operate a municipal water utility for sewer and drinking water, including wastewater treatment. It uses recycled water for geothermal energy and agriculture irrigation. City B will install floating solar on recycled water ponds at their wastewater facility – with the intention to install enough PV panels to fully offset the energy demand of the treatment plant. The City plans to expand the recycled water pipeline to the geothermal energy plant, increasing energy production.



City C will install a solar array on top of the municipality's closed, capped landfill – a Brownfield site – allowing the City to turn the non-productive, closed landfill into an asset.



City D will install carport solar canopies that extend shaded parking and generate energy for the municipally owned airport.



City E will construct a wind farm project consisting of numerous wind turbines to generate electricity.

## Federal Grants can be Paired with these Tax Benefits

Listed below are several federal grant opportunities through the Bipartisan Infrastructure Law and the Inflation Reduction Act that communities can leverage in tandem with the ITC and PTC.<sup>10,11</sup>

Agency	Program	Overview	Implementation Status
EPA	<a href="#">GHG Reduction Fund: Solar for All</a>	<p>Through this competition, Solar for All will award up to 60 grants to states, territories, Tribal governments, municipalities, and nonprofits to expand the number of low-income and disadvantaged communities primed for residential solar investment—enabling millions of low-income households to access affordable, resilient, and clean solar energy.</p>	<p>EPA released \$7 billion <a href="#">Solar for All Notice of Funding Opportunity (NOFO)</a> on June 28, 2023. Application packages must be submitted on or before October 12, 2023.</p>
EPA	<a href="#">Low Emissions Electricity Program</a>	<p>Funding includes \$87 million to fund a wide range of activities to encourage low emissions electricity generation through education, technical assistance, and partnerships with consumers, low income and disadvantaged communities, industry, and state, local, and Tribal governments.</p>	<p><a href="#">Request for Information (RFI)</a> to inform program design closed on January 18, 2023.</p> <p>For more information, contact: <a href="mailto:IRASTakeholders@epa.gov">IRASTakeholders@epa.gov</a>.</p>
DOE SCEP	<p>Grants for Energy Efficiency and Renewable Energy Improvements at Public School Facilities (referred to by DOE as <a href="#">“Renew America’s Schools Program”</a>)</p>	<p>The Renew America’s Schools Program to promote the implementation of clean energy improvements at K-12 public schools across the country. This first-of-its-kind investment, funded by the BIL, aims to help school communities make energy upgrades that will lower utilities costs, improve indoor air quality, and foster healthier learning environments.</p>	<p>The first round of this Funding Opportunity Announcement (FOA) launched in November 2022; the application period closed on April 21, 2023.</p> <p><a href="#">Selectees were announced on June 29, 2023.</a></p> <p><a href="#">Sign up for updates on the program here</a>, or contact: <a href="mailto:schools@doe.gov">schools@doe.gov</a>.</p>

10 In limited scenarios, the tax incentive value is limited if used in tandem with federal grants.

11 Note that local governments can [leverage](#) funding from the American Rescue Plan’s State and Local Fiscal Recovery Fund to hire personnel to help them identify and garner the multiple sources of funding available to support clean energy projects.



Agency	Program	Overview	Implementation Status
DOE SETO and WETO	<a href="#">Solar and Wind Grid Services and Reliability Demonstration Funding Program</a>	<p>The Solar and Wind Grid Services and Reliability Demonstration funding program aims to demonstrate the reliable operation of power systems that have up to 100% of their power contribution coming from solar, wind, and battery storage resources.</p>	<p>DOE announced the <a href="#">Grid Services funding opportunity</a> on August 2, 2022 and the <a href="#">eight selected projects</a> on May 10, 2023.</p>
DOE GDO	<a href="#">Preventing Outages and Enhancing Resilience of the Electric Grid Grants</a>	<p>The objective of this Program is to improve the resilience of the electric grid against disruptive events.</p> <p>Eligible use of funds include the use or construction of distributed energy resources for enhancing system adaptive capacity during disruptive events, including—microgrids and battery storage subcomponents.</p>	<p>Program split between <a href="#">matching grants for industry</a>, and formula grants for States and Tribes.</p> <p>Matching grants funding solicitation opened in November 2022 and closed in March 2023.</p> <p>First round of formula funding applications closed in September 2022.</p>

Agency	Program	Overview	Implementation Status
DOE OCED	<a href="#">Energy Improvements in Rural and Remote Areas</a>	<p>The Energy Improvements in Rural or Remote Areas (ERA) program seeks to improve the resilience, reliability, and affordability of energy systems in communities across the country with 10,000 or fewer people. The ERA program will leverage DOE's expertise and experience in resilient energy solutions to modernize electric generation facilities, address disproportionately high electricity costs, and support new economic opportunities in rural and remote communities.</p>	<p>DOE issued first round <a href="#">Funding Opportunity Announcement (FOA)</a> in May 2023; applications due by October 2023.</p>
DOE GDO	<a href="#">Energy Efficiency and Conservation Block Grant Program</a>	<p>The Energy Efficiency and Conservation Block Grant (EECBG) Program is designed to assist states, local governments, and Tribes in implementing strategies to reduce energy use, to reduce fossil fuel emissions, and to improve energy efficiency.</p>	<p>See the <a href="#">EECBG Program Formula Grant Application Hub</a> for more information.</p>



# Promoting Clean Vehicles Through Direct Pay: A Resource for Cities

Under the Direct Pay provisions of the Inflation Reduction Act (IRA), cities, nonprofit organizations, and other tax-exempt entities can for the first time leverage two tax benefits for clean vehicles:

- **The Alternative Fuel Vehicle Refueling Property Credit**, which supports electric vehicle (EV) charging infrastructure and other types of alternative fueling;
- **The Credit for Qualified Commercial Clean Vehicles**, which supports clean commercial vehicles like EV buses.

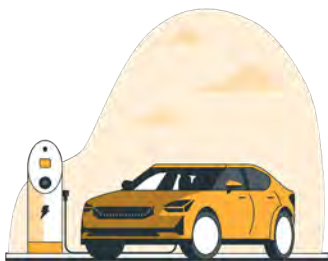
## Alternative Fuel Vehicle Refueling Property Credit

This tax credit incentivizes EV charging stations or alternative refueling stations on qualified properties. Note that this credit can be leveraged in tandem with federal grants, and the generosity of the benefit depends on several factors (more below).

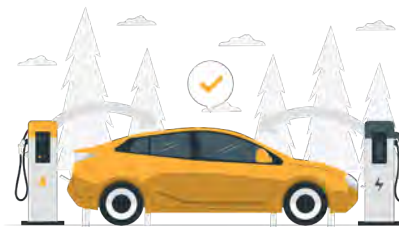
## Credit Amount, Limitations, and Bonuses

- The base tax credit equals 6% of the basis of the property.
- The tax credit increases to 30% if prevailing wage and apprenticeship rules are met.
- The maximum credit is \$100,000 per each single item of property.
- Only projects located in low-income communities or non-urban areas qualify for the benefit; further guidance on specifics is forthcoming.

## Example Projects



City G, located in a low-income census tract, plans to install 350 kW direct current fast chargers (DCFC) curbside on public streets for publicly accessible charging.



City H, located in a non-urban area, was awarded grant funding under the DOT Charging and Fueling Infrastructure Grant Program to install Level 2 and DCFC chargers at various publicly accessible, municipally-owned buildings: City Hall; the public library; the elementary and high schools; and the public park.



City J will install compressed natural gas (CNG) fueling infrastructure at a local airport to support a new fleet of natural gas transit buses and shuttle that provide shuttle services at the airport.

## Federal Grants can be Paired with this Tax Benefit:

Listed below are several federal grant opportunities through the Bipartisan Infrastructure Law and the Inflation Reduction Act that communities can leverage in tandem with the Alternative Fuel Vehicle Refueling Property Credit.<sup>2</sup>

Agency	Program	Overview	Implementation Status
DOT FHWA	<a href="#">Charging and Fueling Infrastructure (CFI) Discretionary Grant Program</a>	The <a href="#">Charging and Fueling Infrastructure Grant Program</a> provides funding to strategically deploy publicly accessible electric vehicle charging infrastructure and other alternative fueling infrastructure.	The fiscal year (FY) 2022 and 2023 Notice of Funding Opportunity ( <a href="#">NOFO</a> ) opened on March 14, 2023 and closed on June 13, 2023. DOT will likely issue the FY 2024 NOFO in 2024.
DOT FHWA/State DOTs	<a href="#">National Electric Vehicle Infrastructure Formula Program (NEVI)</a>	The BIL establishes the NEVI Program to provide funding to States to strategically deploy electric vehicle (EV) charging infrastructure and to establish an interconnected network to facilitate data collection, access, and reliability.	U.S. State DOTs have begun to issue requests for proposals (RFP) for the NEVI program. In July 2023, Hawaii and Ohio were the first U.S. states to award NEVI <a href="#">charging station contracts</a> .
DOT FHWA	<a href="#">Congestion Mitigation and Air Quality Improvement Formula Program (CMAQ)</a>	The BIL continues the Congestion Mitigation and Air Quality Improvement Program (CMAQ) to provide a flexible funding source to State and local governments for transportation projects and programs to help meet the requirements of the Clean Air Act.  The BIL added CMAQ eligibilities, including: the purchase of diesel replacements, or medium-duty or heavy-duty zero emission vehicles and related charging equipment.	Funding allocated to State DOTs on annual basis.

<sup>2</sup> In limited scenarios, the tax incentive value is limited if used in tandem with federal grants.

Agency	Program	Overview	Implementation Status
DOT OST	<a href="#">Rebuilding American Infrastructure with Sustainability and Equity</a>	<p>The RAISE discretionary grant program (formerly known as BUILD and TIGER) provides an opportunity for USDOT to invest in road, rail, transit, and port projects that achieve national objectives.</p> <p>The BIL increased program focus on zero-emission vehicle infrastructure, including <b>EV charging</b>; eligible EV activities include: light-duty vehicle charging; commercial charging; and public transportation charging.</p>	<p>On June 30, 2023, DOT <a href="#">issued</a> 2023 RAISE grant awards.</p>
EPA	<a href="#">Clean Heavy-Duty Vehicle Program</a>	<p>The Inflation Reduction Act invests \$1 billion to replace dirty heavy-duty vehicles with clean, zero-emission vehicles, support zero-emission vehicle infrastructure, and to train and develop workers.</p> <p>Program includes <b>“associated charging and re-fueling infrastructure”</b> as an eligible project cost.</p>	<p>According to its <a href="#">website</a>, EPA anticipates this new funding opportunity may begin later in 2023.</p> <p><a href="#">Sign up for updates on this program from EPA here</a>, or contact <a href="mailto:cleanhdutyvehicles@epa.gov">cleanhdutyvehicles@epa.gov</a>.</p>
EPA	<a href="#">Clean School Bus Program</a>	<p>The program seeks to incentivize and accelerate the replacement of existing school buses with low-emission and Zero Emissions (ZE) school buses. Eligible activities include the replacement of existing internal-combustion engine (ICE) school buses with electric, propane, or compressed natural gas (CNG) school buses, <b>as well as the purchase of electric vehicle supply equipment (EVSE) infrastructure and EVSE installations.</b></p>	<p>EPA issued 2023 <a href="#">Notice of Funding Opportunity (NOFO)</a> on April 24, 2023; applications closed on August 22, 2023.</p>

## Credit for Qualified Commercial Clean Vehicles

This tax credit supports entities like local governments that buy and place in service qualified commercial clean vehicles, including passenger vehicles, buses, ambulances, mobile machinery and other vehicles for use on public streets, roads, and highways.

To qualify, the vehicle must be made by a qualified manufacturer. There are also specific provisions around battery power.<sup>3</sup>

### Credit Amount

The maximum credit is \$7,500 for vehicles weighing less than 14,000 pounds (Class I – III vehicles), and \$40,000 for all other vehicles.

### Example Projects:



In an effort to electrify its fleet, City I will purchase electric recycling and waste trucks; electric public transit buses; and electric snow control/removal vehicles.



City J receives a tax-exempt grant EPA to purchase electric school buses to transition its fleet of school buses to electric buses (EVs).

## Federal Grants can be Paired with this Tax Benefit

Listed below are several federal grant opportunities through the Bipartisan Infrastructure Law and the Inflation Reduction Act that communities can leverage in tandem with the Credit for Qualified Commercial Clean Vehicles.<sup>4,5</sup>

<sup>3</sup> The owner of the vehicle must certify that the vehicle draws significant propulsion from a battery with a capacity of at least 7 kilowatt hours, provided the gross vehicle weight rating (GVWR) is under 14,000 pounds. Alternatively, the vehicle can draw 15 kilowatt hours if the GVWR is over 14,000 pounds. Furthermore, the owner can certify that vehicle is a new fuel cell motor vehicle as defined in Section 30B(b)(3) (e.g. a hydrogen fuel cell vehicle).

<sup>4</sup> In limited scenarios, the tax incentive value is limited if used in tandem with federal grants.

<sup>5</sup> Note that local governments can leverage funding from the American Rescue Plan's State and Local Fiscal Recovery Fund to hire personnel to help them identify and garner the multiple sources of funding available to support clean energy projects.

Agency	Program	Overview	Implementation Status
EPA	<a href="#">Clean School Bus Program</a>	<p>The program seeks to incentivize and accelerate the replacement of existing school buses with low-emission and Zero Emissions (ZE) school buses. Eligible activities include the replacement of existing internal-combustion engine (ICE) school buses with electric, propane, or compressed natural gas (CNG) school buses, as well as the purchase of electric vehicle supply equipment (EVSE) infrastructure and EVSE installations.</p>	<p>EPA issued 2023 <a href="#">Notice of Funding Opportunity (NOFO)</a> on April 24, 2023; applications closed on August 22, 2023.</p>
EPA	<a href="#">Clean Heavy-Duty Vehicle Program</a>	<p>The Inflation IRA invests \$1 billion to replace dirty heavy-duty vehicles with clean, zero-emission vehicles, support zero-emission vehicle infrastructure, and to train and develop workers.</p> <p>EPA will offer grants and/or rebates in funding for clean heavy-duty vehicles between 2023 and 2031.</p>	<p>According to its <a href="#">website</a>, EPA anticipates this new funding opportunity may begin later in 2023.</p> <p><a href="#">Sign up for updates on this program from EPA here</a>, or contact <a href="mailto:cleanhdutyvehicles@epa.gov">cleanhdutyvehicles@epa.gov</a>.</p>
EPA	<a href="#">Diesel Emissions Reduction Act (DERA) Program</a>	<p>The DERA Program funds grants and rebates that protect human health and improve air quality by reducing harmful emissions from diesel engines.</p> <p>The program can be used to replace heavy-duty diesel vehicles and equipment with EVs and chargers.</p>	<p>EPA issued the <a href="#">2022-2023 DERA NOFO</a> on August 4, 2023; applications are due by December 1, 2023.</p>

Agency	Program	Overview	Implementation Status
DOT FTA	<a href="#">Bus and Bus Facilities</a>	<p>The Grants for Buses and Bus Facilities Competitive Program (makes federal resources available to states and direct recipients to replace, rehabilitate and purchase buses and related equipment and to construct bus-related facilities, including technological changes or innovations to modify low or no emission vehicles or facilities. Funding is provided through formula allocations and competitive grants.</p>	<p>On June 26, 2023, FTA <a href="#">announced</a> Grants for Buses and Bus Facilities <a href="#">project selections</a>.</p> <p>Funds remain available for obligation for three fiscal years (2024 - 2026).</p>
DOT FTA	<a href="#">Low or No Emissions Grants</a>	<p>The Low or No Emission competitive program provides funding to state and local governmental authorities for the purchase or lease of zero-emission and low-emission transit buses as well as acquisition, construction, and leasing of required supporting facilities.</p>	<p>On June 26, 2023, FTA <a href="#">announced</a> billion in FY23 Low- and No-Emission project selections.</p> <p>Funds remain available for obligation for three fiscal years (2024 - 2026).</p>