

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.¹



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](#).

¹ 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.



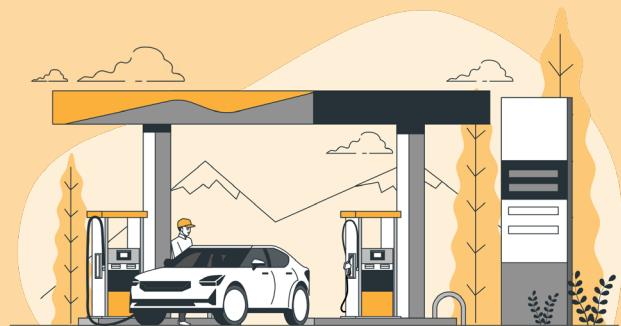
Direct Pay in Action: Madison, WI

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](#).