Direct Pay Tax Credit Questions & Answers

The following Q&A was derived from webinars hosted by the Beneficial Electrification League featuring experts from NYU's Tax Law Center. For more detailed information and resources around eligibility and applying for direct pay tax credits, visit the BEL website.

Pre-registration

What taxable years does direct pay apply to?

- Direct pay is available for taxable years beginning after December 31, 2022. Note that if your taxable year begins in the middle of the calendar year, even though one of your taxable years ends during 2023, direct pay only applies to the taxable year that begins in 2023.

Is pre-registration required?

- Yes, pre-filing registration is required for all entities that plan to claim direct pay. You can find the pre-filing registration portal here and the instructions for using it here.

IRS pre-registration form

When do I need to register?

- In general, you should register:
  - After placing an investment property or production facility in service, but no earlier than the beginning of the tax period when you earn the credit.
  - At least 120 days before the due date (including extensions) for the return where you report the credits. Use the form identified in the instructions to apply for an extension of the time to file your return.

Is there a deadline for filing to claim direct pay?

- An elective payment election may only be made on an original, timely filed return (including extensions). This means the deadline is the due date (including extensions) for the tax return for the taxable year for which the election is made. For most tax exempt and government entities including tribal governments this is generally 4.5 months (for example, May 15 for a calendar year taxpayer) (or up to 10.5 months with extensions) after the end of the entity's tax year.

Sequestration Risk

Are tax credits potentially subject to sequestration risk, or would they be treated as an overpayment of tax similar to traditional tax returns?

- The mechanism for direct pay is that the credit is reduced to zero, and the entity shall be treated as making a payment against the tax imposed by subtitle A of the Tax Code. Unlike certain direct pay bonds, the credits themselves are not subject to sequestration. Direct pay payments are grossed up to account for sequestration (see Inflation Reduction Act section 13801(f))

Are direct pay tax credits dependent on repetitive congressional appropriations?

- All credits are funded for the life of the credits. Generally, these credits run for 10 years. Therefore, they generally expire for projects that commence construction after 2032.

Domestic Content & Labor Requirements

Do entities need to meet both the labor and domestic content requirements to claim any of the credit?

- If the project is 1MW+ nameplate capacity, a failure to meet the labor requirements would reduce many credits by 80%. So, for example, the ITC is reduced from a 30% credit to a 6% credit if labor requirements are not met. If a project is <1 MW nameplate capacity, it does not need to meet the labor requirements to get the full base credit.

  Entities claiming elective pay for ITC or PTC projects with a max output of 1MW+ beginning construction in 2024 or later that do not meet the domestic content requirements will receive a reduced credit. The credit reduction is 10% for projects beginning construction in 2024, 15% for projects beginning construction in 2025, and 100% for projects beginning construction in 2026 or later. ITC and PTC credits for projects with a max output of <1MW are not reduced if the project fails to meet the domestic content requirements.

Is the 10% reduction for not meeting domestic content requirements (if can't meet an exception or show good faith effort) based on 10% of the base credit or the project amount? So, in the example, is the reduction 10% of the $1.5 million amount or the $600,000 credit amount?

- When domestic content requirements are not met, the credit itself is multiplied by the "applicable percentage." For projects beginning construction in 2025, the applicable percentage is 85%, That means the credit is reduced by 15% if the requirements apply and are not met.

Are there any exceptions to the domestic content phaseout for direct pay?

- There are two statutory exceptions to the domestic content phaseout for direct pay: (1) if satisfying the domestic content requirements would increase the overall costs of construction by more than 25%, or (2) if relevant steel, iron, or manufactured products are not produced in the US in sufficient and reasonably available quantity or quality. If an entity qualifies for either exception, its credit will not be reduced if its project fails to satisfy the domestic content requirements. Notice 2024-9 states that an entity with a project beginning construction in 2024 will qualify for an exception to the domestic content requirements for direct pay if it provides an attestation that it made a good faith determination that the facility qualified for one of the exceptions. The entity must include the attestation with its other tax forms when claiming direct pay. Treasury has yet to release guidance on how the exceptions will work for projects beginning construction in 2025 or later.

When prevailing wage is referenced, is it only requiring appropriate wages, or does that mean the Davis Bacon applies?

- Some helpful resources here. https://www.irs.gov/credits-deductions/frequently-asked-questions-about-the-prevailing-wage-and-apprenticeship-under-the-inflation-reduction-act

Timeline

What about projects that commenced in 2023?

- The domestic content requirement (and direct pay phaseout) did not apply to projects that commenced in 2023. See section 45(b)(10)(C)(i)

Is the automatic 6-month extension for entities that do not normally file taxes applied year after year, or is this just for this first year?

- The guidance reads in relevant part as follows:

  > *"Subject to issuance of guidance that specifies the manner in which an entity for which no Federal income tax return is required under sections 6011 or 6033(a) of the Code could request an extension of time to file, an automatic paperless six-month extension from the original due date is deemed to be allowed."*

Is the credit lost if an amended return is filed?

- The proposed guidance states: "No elective payment election may be made or revised on an amended return or by filing an administrative adjustment request under section 6227 of the Code."

Financing

Can interest on debt or loans used to finance the project be included in the basis?

- If you are financing with tax exempt bonds, the project may be subject to credit reduction. See section 45(b)(3) and 48(a)(4).

Partnerships

Are partnerships eligible for direct pay?

- The proposed elective pay guidance generally prohibits partnerships from claiming elective pay. There are exceptions, primarily for credits under 45V (clean hydrogen), 45X (advanced manufacturing PTC), and 45Q (CCS). The proposed rules note a pathway for project owners to elect out of partnership status and use tenancy-in-common structures. This is a potential pathway for developers who want to co-own property and claim elective pay.