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2022 Inflation Reduction Act Tax Incentives & Provisions

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On July 27, 2022, Sens. Joe Manchin (D-WV) and Chuck Schumer (D-NY) released legislative text for budget reconciliation legislation, also known as the Inflation Reduction Act of 2022. Twelve days later, the U.S. Senate on August 7 approved the bill on a party-line vote, with all 50 Democratic Senators voting for the legislation and all Republicans voting against it. Vice President Kamala Harris cast the decisive 51st vote in favor of the legislation. The House of Representatives then approved the bill on August 12, with all 220 Democrats voting for, and 207 Republicans voting against (with four Republicans not voting) the bill. The House made no changes to the Senate-passed bill, which President Biden signed into law on August 16.

The act includes the largest-ever U.S. investment committed to combat climate change, allocating $369 billion to energy security and clean energy programs over the next 10 years, including provisions incentivizing manufacturing of clean energy equipment and electric vehicles domestically.

Overall, the act modifies many of the current energy-related tax credits and introduces significant new credits and structures intended to facilitate long-term investment in the renewables industry.

Base and Bonus Credit Rate Structure

The act introduces a new credit structure whereby the tax incentives are subject to a base rate and a "bonus rate." To qualify for the bonus rate, projects must satisfy certain wage and apprenticeship requirements implemented to ensure both the payment of prevailing wages and that a certain percentage of total labor hours are performed by qualified apprentices.

Projects under 1MW or that begin construction within 60 days of the date when Treasury publishes guidance regarding the wage and apprenticeship requirements are automatically eligible for the bonus credit.

Additional bonus credits may also be available for certain projects that are placed in service after December 31, 2022, and that meet domestic content requirements. For a project to qualify for this 10% bonus credit, taxpayers must ensure that a certain percentage of any steel, iron or manufactured product that is part of the project at the time of completion was produced in the United States.

Facilities located in energy communities are also eligible for up to a 10% additional credit. Energy communities are defined as a brownfield site, an area with significant fossil fuel employment, or a census tract or any immediately adjacent census tract in which, after December 31, 1999, a coal mine has closed, or, after December 31, 2009, a coal-fired electric generating unit has been retired.

Credit Monetization Changes

The act includes two new options for the monetization of the tax credits in the form of direct pay and transferability. Direct pay allows certain tax-exempt entities including state or local governments and Indian tribal governments to receive tax refunds in the amount of the credits as an overpayment of tax. Taxpayers not eligible for direct pay can elect a one-time transfer of all or a portion of certain tax credits for cash to unrelated taxpayers. The cash received for the transfer of the credits is not included in the income, nor is the cash paid for the transferred credits deducted from income. The IRS may release registration requirements or other procedures to govern these tax credit transfers.

The act also increases the carryback period for certain credits to three years for credits eligible to be transferred from the current one-year carryback and extends the carryforward period two additional years, from 20 to 22 years.

Clean Energy Provisions

A number of additional changes to the energy related tax credits are summarized below:

- Production Tax Credit (PTC) and Investment Tax Credit (ITC)
  The PTC and ITC are extended and enhanced with the restoration to full rates for projects that begin construction prior to January 1, 2025, subject to prevailing wage and apprenticeship requirements. Wind and solar projects are also eligible for bonus credits for projects placed in service in low-income communities. Solar projects have the option to claim the PTC and the ITC is expanded to include energy storage as well as biogas and microgrid property.

- Clean energy PTC and ITC
  New technology-neutral credits will be available for qualified zero-emission facilities that begin construction after December 31, 2024. The credits begin to phase out the earlier of the calendar year when the annual greenhouse gas emissions from the production of electricity are equal to or less than 25% of the annual greenhouse gas emissions from the production of electricity in the U.S. for calendar year 2022 or 2032.

- Carbon Capture Sequestration Credit
  The act extends the "begin construction" date to December 31, 2032 and changes the credit rate and carbon capture requirements for both direct air capture and electricity-generating facilities. Qualification for the bonus rate requires satisfaction of prevailing wage and apprenticeship requirements and there is an option for all taxpayers to elect a direct payment of the credit for the first five years of operation.

- Clean Hydrogen
  A new tax credit is established for facilities that produce clean hydrogen at a qualified facility after December 31, 2022, and that begin construction prior to January 1, 2033. Taxpayers can claim the PTC or ITC with bonus rates subject to their fulfilling prevailing wage and apprenticeship requirements. All taxpayers can elect a direct payment of the credit for the first five years of operation.

- Advanced Manufacturing Production Credit
  A new production tax credit is available beginning in 2023 for each eligible renewable energy component produced by the taxpayer in the U.S. and sold to an unrelated person. Eligible components include any solar or wind component, qualifying inverters and qualifying battery components and any applicable critical mineral. The credit is fully transferable and there is also an option for direct payment during the first five years of production.

- Sustainable Aviation Fuel and Clean Fuel
  The act includes new credits for sustainable aviation fuel used or sold as part of a qualified mixture between January 1, 2023, and December 31, 2024, and clean transportation fuel produced and sold after December 31, 2024, and before January 1, 2028.

- Electric Vehicles
  The existing $7,500 credit is modified by removing the current provision that begins phasing out the credit once a manufacturer sells 200,000 qualifying vehicles per manufacturer. The act also introduces limitations regarding domestic assembly requirements and for taxpayers with income over certain thresholds. Beginning in 2024, the act provides an option to transfer the credit to qualifying dealers and there is no credit available for purchases after December 31, 2032.

  The act also establishes a new credit for previously owned clean vehicles on the initial transfer. The credit is allowed for vehicles with a sales price of $25,000 or less that have a model year at least two years old. Similar to the credit for a new EV, this credit is limited for taxpayers with income over certain thresholds.

  Immediately following President Biden's signing of the bill, the U.S. Department of the Treasury and the Internal Revenue Service published initial information – guidance and FAQs – on changes to the tax credit for electric vehicles strengthened by the new legislation.

- Alternative Refueling Property
  The credit that expired on December 31, 2021, is extended and modified for property placed in service through December 31, 2032. The eligible expenses are increased and the per location limit is removed. However, beginning in 2023, only property placed in service in low-income or rural census tracts will be eligible for the credit. Prevailing wage and apprenticeship requirements must be satisfied to qualify for the full credit.

- Commercial Clean Vehicles
  Qualified commercial vehicles acquired after December 31, 2022, and before January 1, 2033, are eligible for a credit equal to the lesser of 30% of the cost of the vehicle not powered by a gasoline or diesel internal combustion engine or the incremental cost of the vehicle. The credit cannot exceed $7,500 for vehicles weighing less than 14,000 pounds or $40,000 for all other vehicles, and is available only for depreciable property acquired from qualified manufacturers.

- Additional clean energy and efficiency incentives for individuals included in the act include:
  - Extension, increase and modification of nonbusiness energy property credit.
  - Residential clean energy credit.
  - Energy efficient commercial buildings deduction.
  - Extension, increase and modifications of new energy efficient home credit.

Insights

- Projects placed in service in 2022, including before the act's date of enactment, may be eligible for the PTC and the ITC at full rates. Additional guidance around the prevailing wage and apprenticeship requirements is forthcoming and is expected to include required administrative procedures and documentation to meet the certification requirement to qualify for the bonus rates.

- Direct pay, albeit limited in scope, in addition to the ability to transfer credits for cash, provides new flexibility in how certain tax credits may be monetized. Combined with the continuation of traditional tax equity structures, this option will impact capital and financing structures going forward.