

Taking on Climate Change:

Navigating a path forward in the IRA era

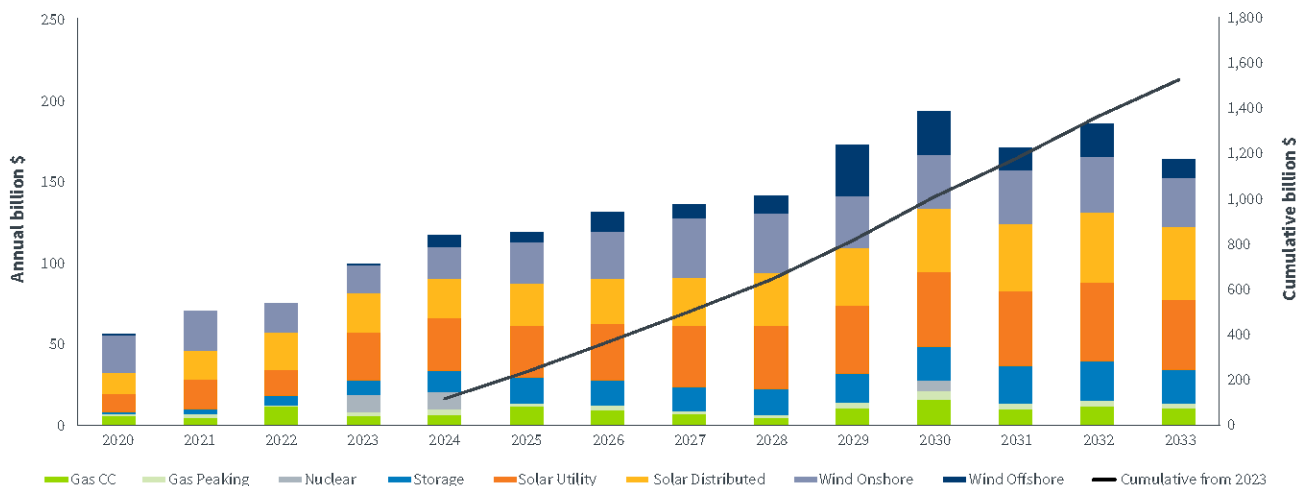


With the passage of the Inflation Reduction Act of 2022 (IRA), the United States has made a statement about its commitment to combating climate change. According to researchers at [Wood Mackenzie](#), the IRA provides

“Over US\$300 billion allocated to spur investments in zero carbon power generation supply, emissions reduction technology, and electrification and energy efficiency programs...”

Many industry analysts and professionals predict that the IRA will spur investment and progress in clean energy over the next 10 years. Figure 1 below is a projection of how this will roll out through 2033.

Figure 1. Projected U.S. renewable energy investment under the Inflation Reduction Act.



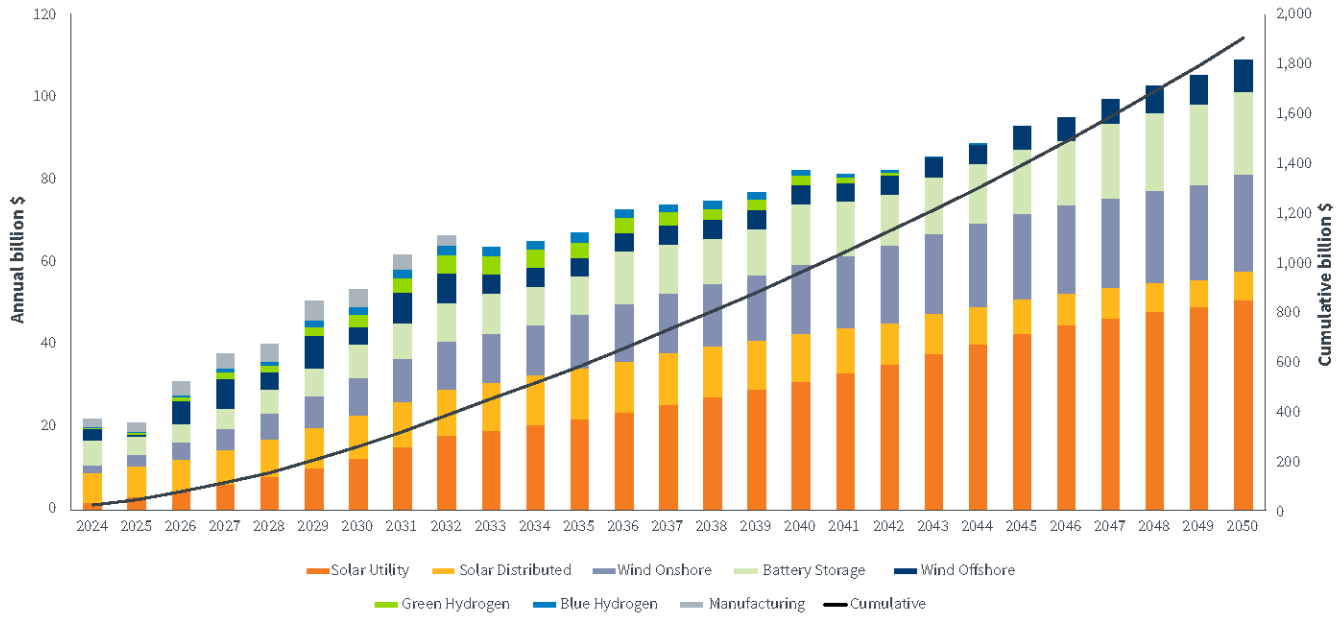
Source: Wood Mackenzie

Core to the IRA’s value proposition is its introduction of new federal tax incentives to encourage investment in the clean energy space. The [U.S. Department of Labor](#) estimates that over 70% of investment in the IRA will be delivered via tax incentives.

Similarly, a recent report prepared by the Joint Committee on Taxation titled [“Estimates of Federal Tax Expenditures for Fiscal Years 2023 - 2027”](#) estimates that the corporate tax incentives specific to energy will be valued at over \$100 billion through 2027.

For an expanded view of the impact of tax credits in the IRA, Figure 2 below provides a projection through 2050.

Figure 2. Total value of IRA tax credits, 2024–2050.



Source: Wood Mackenzie

This brief provides an overview and insights into how investors, developers, and credit buyers in the clean energy space can take advantage of these tax incentives to ramp up their organization’s clean energy activities, with a particular focus on the impacts of transferability, direct pay, tax credit adders, new prevailing wage rules, domestic content and U.S.

manufacturing impacts, plus perspectives on how the IRA is elevating the role of energy storage in the renewable energy mix. In addition, this brief will examine other IRA opportunities in the new energy landscape, such as the Greenhouse Gas Reduction Fund.



The window of opportunity is open

The IRA includes several federal incentives that are actionable now. Below is a closer look at some of these incentives that will be rolling out in the coming years.

First among these incentives is *transferability*. While certainly not a new tax concept, transferability is new in the federal clean energy tax credit market via the IRA. In a break from previous U.S. tax policy, taxpayers are now allowed to transfer any portion or all of an eligible taxpayer's federal tax credits to an unrelated taxpayer for cash consideration. This transferability is available across a broad array of clean energy investments, including a number of renewable energy, nuclear, and hydrogen investment and production tax credits.

Though available to a wide variety of taxpayers, the IRA's transferability rules are creating a new market opportunity for corporations that do not want to take an equity ownership in renewable energy projects yet still desire to take advantage

of certain federal tax credits. Kayla Schultz, a partner in CohnReznick LLP's Renewable Energy and Industry Practice, noted that

“The transferability rules offered by the IRA provide a great avenue for corporations desiring simpler accounting and a non-equity ownership to participate in the renewable energy markets as part of their sustainability strategy, while also having a positive impact on net income as the credits are purchased at a discount.”

Similarly, private entities, solar or wind developers for example, will now be able to monetize their tax credits without most of the complexities of traditional tax equity structures by simply selling their tax credits.

Although tax credit transfers will become an attractive financing mechanism and increase the tax equity market, risks remain. Even as the tax credit transfer market becomes established and transactions are more standardized, it is apparent and will remain paramount that all stakeholders continue to focus on rigorous due diligence to protect from various risks.

A second change in the landscape driven by the IRA is the introduction of *direct pay* for both tax-exempt and non-federal governmental entities. As per the [White House](#), “tax-exempt and governmental entities will, for the first time, be able to receive a payment equal to the full value of tax credits for building qualifying clean energy projects. Unlike competitive grant and loan programs, in which applicants may not receive an award, direct pay allows entities to get their cash payment if they meet the requirements for both direct pay and the underlying tax credit.” This also applies to quasi-federal entities like the Tennessee Valley Authority that are also eligible for this direct pay feature in the IRA.

Lee J. Peterson, JD, senior manager in CohnReznick’s Project Finance and Consulting Group, commented on how direct pay rules under the IRA are contributing to the changing energy landscape:

“This facet of the IRA is a gamechanger for state and local government agencies. Historically relegated to the sidelines and in a reactive mode, these entities are now incentivized to take a leadership role in shaping a cleaner energy future.”

Lee went on to explain that, while the opportunity is there for these government and other non-profit entities to leverage, navigating the new rules in the IRA are complex, touching numerous different federal agencies and regulations. Tapping professional advice in navigating this new territory will help ensure that state and local governments and non-profits receive the full benefit of these incentives in the IRA.

A third tax benefit of note and available now in the [IRA](#) is the Low-Income Communities Bonus Credit Program. As per the IRA, this program has

“...created an additional tax credit incentive of either 10% or 20% for solar and wind projects that benefit low-income communities.”

With an emphasis on reaching historically disadvantaged communities, this applies only to solar and wind technologies

in 2023 and 2024, with energy storage also eligible if part of, or “connected to,” the eligible solar or wind project. A broader selection of energy technology will be eligible in 2025 and beyond. However, for any given year, there will only be 1.8GW of capacity allowed for the low-income bonus credit. In addition, taxpayers will not qualify for this additional credit amount unless they apply to the IRS for an allocation and are awarded an allocation. Taxpayers cannot simply assume they are eligible to claim this credit increase.

During the initial 30-day application window for the program, the IRS received applications that represented more than four times the total 1.8GW capacity available for the 2023 program. As many predicted, the most oversubscribed categories were facilities located in low-income communities (Category 1), specifically the sub-reservation for applicants with front of the meter (FTM) facilities described in § 1.48(e)-1(i)(2)(iii) as well as non-residential behind the meter (BTM) facilities that meet the requirements of § 1.48(e)-1(i)(2)(i), and Category 4 facilities that are Qualified Low-Income Economic Benefit Projects. In these categories, the additional selection criteria sub-category capacity is oversubscribed. Meanwhile, Category 2 facilities, facilities located on Indian Land, were undersubscribed for both the additional selection criteria and non-additional selection criteria applicants. Section 8.03 of Revenue Procedure 2023-27 states that if an additional selection criteria sub-category is oversubscribed, the additional selection criteria applicants will be prioritized and processed before non-additional selection criteria applicants in the related category. Furthermore, Treasury and the IRS can adjust the initial reservation capacity. Treasury and the IRS have not suggested if they would change the capacity allocations based on the results of the initial application window.

The IRS and Treasury have allocated some low-income bonus adders, as noted in the Department of Energy’s Program Capacity Dashboard, which reflects that approximately 37% of the total 1.8GW allocation has been approved by the IRS as of the first week of February 2024. The Treasury, on Feb 12, announced that the 2023 allocation period will close on Feb. 29, and applications for the 2024 allocation period will then be accepted. Those not receiving an award for 2023 will need to re-apply if they wish to be considered for 2024.



Separately, the IRA also contains other opportunities for obtaining additional tax credit amounts above the statutory base and bonus regime put in place by the IRA. One such additional tax credit adder is the domestic content adder. The goal of this rule is to create higher demand for domestic content in newly constructed clean energy assets, and thereby separately stimulate the domestic manufacture of such components integral to tax credit eligible projects. To qualify for this tax credit adder, a manufacturer will need to provide data to verify its product's contribution to the project meeting the domestic content requirements. Many have requested some relief from these provisions since many manufacturers are unwilling to provide this data to their customers. Some transactions have been completed with the expectation that this adder will be satisfied, but a standardized solution has been elusive. This section of the IRA is one of the more complex features, leaving the industry with many open questions and a need for further clarification in order to properly calculate compliance with the domestic content regulations.

The passage of the IRA has expanded tax insurance markets to include IRA-backed renewable energy projects. Some renewable energy projects may have some amount of uncertainty of compliance with new rules (such as prevailing wage, domestic content, and technology integration to name a few). IRA tax insurance enables parties in an IRA renewable energy tax credit transaction to have a policy in place to transfer the risks associated with these types of projects.

This new tax insurance market requires some additional explanation. The IRA offers various incentives that all carry their own level of risk. The provision of insurance has been the solution to manage risk and get deals done. Insurance providers offer a la carte options to indemnify risk beyond the fair market value step-ups and traditional fixed tax assumptions such as recapture and begun construction. Insurance is now available for prevailing wage and apprenticeship requirements, tax credit adders, and the transfer itself. Many of the insurance policies will offer flexibility to extend coverage to incentives that are not determined until the asset is ready and available for its stated use.



Setting the bar: The role and impact of prevailing wage and apprenticeship rules

With an emphasis on creating good-paying jobs for communities and industries across the U.S., the IRA includes separate but overlapping prevailing wage rules and apprenticeship requirements for most of the energy incentives. For those experienced in labor regulations, this is similar to the Davis-Bacon Act, but is focused specifically on renewable energy projects, and varies in specifics as compared to Davis-Bacon. These are new requirements for renewable energy projects in the U.S. and vary by specific tax credit. For the production tax credit and investment tax credit the prevailing wage rules are applicable only to projects that are 1 MW or greater in net output generating capacity, and includes payments to laborers and mechanics employed in the construction, alteration, or repairs of renewable energy facilities, but not their servicing and maintenance.

While prevailing wage requirements will likely benefit the labor force in numerous communities, this new compliance obligation does create some risk and expense for renewable energy investors and developers. Stringent compliance and documentation practices are a must, and seeking professional advice on meeting these labor requirements is recommended.

When the prevailing wage guidelines are coupled with the additional apprenticeship participation requirements under the IRA, there is a careful balance that must be maintained

to comply with both wage and apprenticeship requirements. Failing to maintain the appropriate mix of journeymen versus apprentice labor can impact compliance with the prevailing wage requirement. This creates a scenario where many owners and contractors may be compliant with the prevailing wage aspects but not the apprenticeship requirements or vice versa. Because of this, and the awareness of project underwriters/lenders, insurers, and owner/operators, active and ongoing monitoring of compliance with the regulations is critical to mitigating any penalties and interest that could be levied by enforcement agencies.

Because taxpayers will only receive an increase in the base amount of the tax credit by five times if they comply with these wage and apprentice rules, it is absolutely critical that all stakeholders involved in renewable energy transactions have strong controls in place and pay close attention to satisfaction of the prevailing wage and apprenticeship compliance requirements.

Key takeaways for project construction professionals will be the ongoing diligence requirements for prevailing wage and apprenticeship administration and documentation beyond the construction period to avoid accumulating penalties. Developers will need to keep up with the administrative aspects of both the prevailing wage and apprenticeship recordkeeping requirements of the IRA so tax credit investors, tax credit buyers, and tax credit insurers can verify that prevailing wage and apprenticeship standards have been met with the same issues being of concern to prospective buyers of such projects.



Energy storage: Filling gaps and improving resiliency

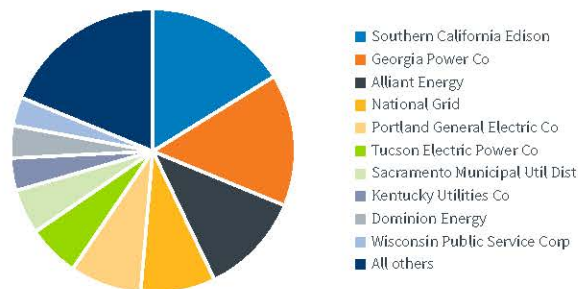
Increased concerns of resiliency and dispatchability makes energy storage more critical as an increasing percentage of load, including base load, is met with renewables. The IRA has responded to these concerns by providing tax incentives to accelerate energy storage investments.

While the exact dollar value of this opportunity is difficult to pin down, Wood Mackenzie analysts estimate that the total opportunity for storage tax incentives is around \$5 billion per year through 2028. This could increase to as much as \$9 billion per year by 2050, with much of it likely in the area of electricity storage technologies versus thermal storage.

Figures 3 and 4 provide an additional perspective on the direction of storage projects. Utility owned electric storage, or BESS (Battery Energy Storage Systems), projects in development total nearly 3,400 MW, while BESS projects in operation total over 2,100 MW.

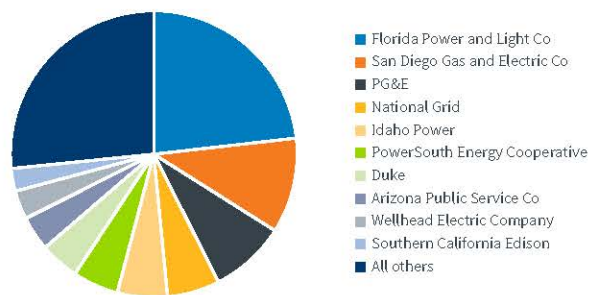
Among the incentives for moving ahead with energy storage projects are some innovative tax policies. One in particular removes an historic challenge to energy storage investments, namely the ability to opt out of investment tax credit normalization rules for public utilities otherwise subject to those rules. In addition, the IRA now allows energy storage tax credits on a standalone basis, whereas in the past they were

Figure 3. U.S. utility owned BESS projects in development.



Source: Wood Mackenzie

Figure 4. U.S. utility owned BESS projects in operation.



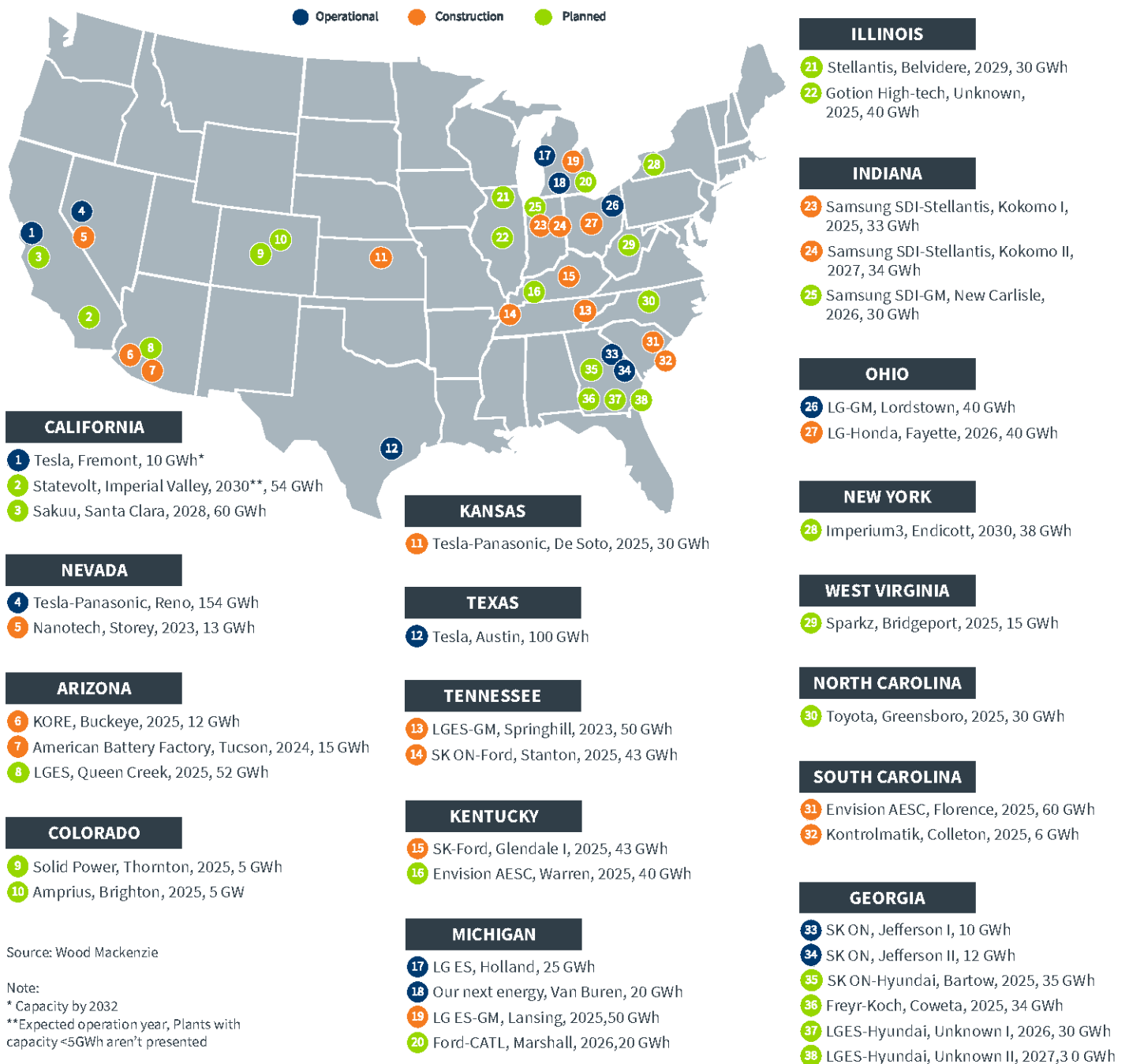
Source: Wood Mackenzie

available only when combined with other energy generation projects, typically in the wind and solar sectors, and then, only if placed in service at the same time. Also, energy storage assets will be allowed to claim five-year MACRS (modified accelerated cost recovery system) accelerated depreciation (similar to other investment tax credits, or ITC, or production tax credits, or PTC, generating assets) beginning in 2025. Thus, whether taken alone or all together, these new storage specific income tax

accounting rules will absolutely increase project flexibility and dramatically accelerate capital and tax motivated investments in storage while providing for greater grid resiliency.

One result of these new energy storage features is an explosion of energy storage manufacturing in the U.S. Figure 5 below highlights the number and location of gigafactories that are operational, under construction, or planned.

Figure 5. Location of operational, under construction, and planned gigafactories in the U.S.



Source: Wood Mackenzie

Note:

* Capacity by 2032

**Expected operation year, Plants with capacity <5GWh aren't presented

Additional IRA opportunities in the new energy landscape

Under the authorization of the IRA, the U.S. EPA will be administering the Greenhouse Gas Reduction Fund (GGRF). The GGRF is a \$27 billion fund to incentivize investment in addressing the climate crisis and accelerating U.S. economic competitiveness. The GGRF is designed to mobilize private capital by leveraging these funds as much as 10 times – and maybe much more, to address the climate crisis, ensure the country’s economic competitiveness and promote energy independence while lowering energy costs and promoting economic revitalization to communities that have historically been left behind.

The GGRF is composed of three grant competitions that were announced in the summer of 2023: the \$14 billion National Clean Investment Fund, the \$6 billion Clean Communities Investment Accelerator, and the \$7 billion Solar for All competition.

The deadlines for the three primary grant applications have passed, and awards will be awarded in Spring 2024. That said, these awards will be in the hundreds of millions, or even billions. Projects that want to be beneficiaries of this program could still access these funds in the future via one of these grant recipients.

Another potential gamechanger delivered by the IRA is a new section of the tax code in Section 45X. This is a new production tax credit for businesses that manufacture and sell a defined list of clean energy components or minerals used in clean energy industrial sectors. Section 45X is poised to be another accelerator in the clean energy space because it serves the above-mentioned domestic content policy, and because the Section 45X tax credits can either be sold for cash under the rules in Section 6418 or be rebated for cash from Treasury under the rules in Section 6417. Thus, the Section 45X tax credit now creates an incentive for the domestic production of products and minerals critical to the growth of the U.S. clean energy economy; examples include wind turbine blades, solar panel wafers, electricity inverters, batteries, and critical minerals such as lithium used in EVs and battery storage devices.

This is another example from the IRA where the results will be impressive, but working through the requirements to get to the point of success will require professional help in understanding and applying the nuances of the IRA to qualify for the tax incentives.

While the IRA is creating a new energy landscape in the U.S., this is a landscape that can be described as very fluid at times. For example, two U.S. solar companies are working to undo the Biden administration’s two-year pause on solar tariffs for Asian companies involved in the design and manufacturing of solar panels and related equipment. While this pause is purportedly intended to accelerate, or at least prevent the slow down, of the availability of solar panels and related infrastructure, it is having adverse impacts on domestic solar panel and equipment manufacturers. The two U.S. companies that filed the [complaint](#) with the U.S. Court of International Trade in December 2023 are Auxin Solar, a California-based solar module manufacturer, and Concept Clean Energy, a U.S.-operated designer of solar structures. The complaint is contesting the administration’s tariff moratorium that is expected to end in June 2024.

Driving the new energy economy forward

The IRA is changing the clean energy landscape in the U.S. With its many incentives, the IRA is creating a new era in the development of renewable energy in the U.S.

While this is exciting and arguably overdue, this does create challenges in navigating the hefty set of new regulations and requirements. Stakeholders must have a strong understanding of all the tax provisions, financial assistance, and compliance and monitoring requirements to access and leverage the most value from the IRA. This, along with rigorous due diligence is key in helping protect against downside risk. For insights into how to make the IRA part of your energy success, visit [CohnReznick LLP’s Inflation Reduction Act resource center](#).

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For more information on CohnReznick, visit www.cohnreznick.com, and to learn more about our Renewable Energy Industry Practice, visit www.cohnreznick.com/industries/renewable-energy.

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