

THE DIRECT PAY PROGRAM

For the first time, the federal government has created a pathway for local governments and non-profits to take advantage of clean energy tax credits directly. The Inflation Reduction Act amends the tax code to allow non-taxable entities investing in an energy project to receive a “[direct payment](#)” of a tax credit’s value in lieu of credits against tax liability. This provision is applicable for projects put into service between 2023 and 2032.

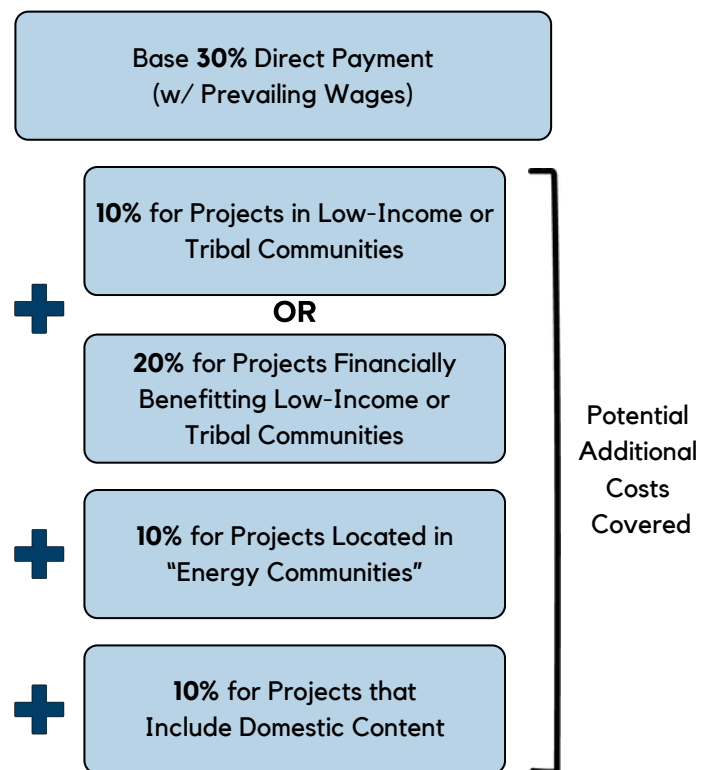
What is the Direct Pay Program?

[Direct pay](#) (also referred to as “elective pay”) is a mechanism that allows states, cities and local municipalities, tribes and other tax-exempt entities, such as municipal water or power utilities and school districts, to recoup the value of certain clean energy tax credits as cash payments from the Internal Revenue Service. For example, the Investment Tax Credit (ITC) offers renewable electricity developers a credit against the project cost, and this credit is now available to non-taxable entities through direct pay. In addition to the base 30% direct payment (assuming the prevailing wage and apprenticeship requirements are met—though projects under 1MW automatically receive the higher credit), there are “bonus credits” that can cover even more of the total project costs. Projects that include domestic content, are located in [“energy communities,”](#) and/or benefit low-income communities can receive an additional 10-40% of costs covered. Importantly, the direct pay program allows for “stacking” the applicable tax credit with federal or state grant money for the same project, for up to 100% of the project costs!

What are the steps to receive the tax credit amount under the Direct Pay Program?

There are a few steps to receiving a successful elective payment:

1. Identify and pursue the [qualifying project or activity](#).
2. Determine your municipality’s tax year. Your tax year will determine the due date for your credit, which will fall 4.5 months after the last day of the tax year (10.5 months if an extension is requested).
3. Complete pre-filing registration with the IRS. This includes providing information about which applicable credits your municipality intends to earn and each eligible project/property that will contribute to the applicable credit.
4. Satisfy the eligibility requirements for the credit and any applicable bonus credits for a given tax year.
5. File a timely return with the IRS, including a Form 990-T, Form 3800, and any credit-specific forms.
6. Receive the refund after IRS review.



A municipality that makes an election is treated as having made a payment against federal income taxes for the taxable year with respect to which an applicable credit was determined, in the amount of such credit. Since a municipality has no tax liability, the municipality will receive a refund equal to the full amount of the applicable credit.

Additional Resources

The IRS has a number of resources available to local leaders, including [FAQs](#) and [fact sheets](#) that outline key information. Additionally, the World Resources Institute, a Cities for Smart Surfaces project partner, has released a report on [key IRA incentive programs](#).