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Tax Credit Transfers and Direct Payments in the Inflation Reduction Act of 2022

The Inflation Reduction Act of 2022 (IRA; P.L. 117-169) created or modified 20 energy-related income tax credits. These credits subsidize clean or efficient energy production and usage by individuals and businesses.

The IRA also created two credit delivery mechanisms that extend the full value of IRA credits to organizations with little to no tax liability. This *In Focus* explains how these mechanisms benefit untaxed entities and businesses with low tax liabilities, respectively.

Direct (Cash) Payments

Federal business tax credits have traditionally been *nonrefundable*, meaning that if a business's credits exceed its tax liabilities, the business cannot receive the difference as a refund. For example, if a business owes $4,000 of income taxes but is eligible for $7,000 of credits, those credits reduce the business's income taxes to $0. However, the federal government does not send the business a refund for the remaining $3,000.

This presents challenges for untaxed entities such as state and local governments, school districts, and nonprofits. Because these organizations do not pay federal income taxes, they implicitly cannot benefit from nonrefundable tax credits. Lawmakers have at times changed the income tax code to incentivize certain behaviors (e.g., higher investment) among businesses and individuals, but nonprofits and other groups exempt from income tax do not respond to such incentives. To incentivize clean energy investments across a wider range of organizations, the IRA allows certain untaxed entities to receive direct cash payments of equal value to 12 nonrefundable tax credits:

- the alternative fuel vehicle refueling property credit (AFVRPC; Internal Revenue Code [IRC] §30C);
- the production tax credit (IRC §45);
- the credit for carbon oxide sequestration (IRC §45Q);
- the zero-emission nuclear power production credit (IRC §45U);
- the clean hydrogen production credit (IRC §45V);
- the credit for qualified commercial clean vehicles (IRC §45W);
- the advanced manufacturing production credit (IRC §45X);
- the clean electricity production credit (IRC §45Y);
- the clean fuel production credit (IRC §45Z);
- the investment tax credit (IRC §48);
- the qualifying advanced energy property credit (IRC §48C); and
- the clean electricity investment credit (IRC §48E).

Organizations receiving direct payments must file a return with the IRS at the tax filing deadline (with applicable extensions). Payments are only issued after returns have been processed. The untaxed entities eligible for direct payments are

- any private-sector entity exempt from federal income taxes, including 501(c)(3) organizations such as hospitals, private colleges, and think tanks;
- state governments and political subdivisions thereof (including city governments, county governments, and school districts) and Indian tribal governments;
- the Tennessee Valley Authority;
- Alaska Native Corporations; and
- rural electricity cooperatives.

Organizations that are not exempt from taxation can also elect to claim direct payments in place of the credits for carbon oxide sequestration, clean hydrogen production, and advanced manufacturing production. They may do so for five years, starting with the year a facility is placed in service. This election cannot be made after 2032.

Credit Transfers

Entities not eligible for direct payments may *transfer* any of the credits listed in the previous section, with the exception of the credit for qualified commercial clean vehicles. *Credit transfers* occur when one business sells its credits to another at an agreed-upon price in exchange for cash.

Such transfers hold two potential benefits for firms. First, businesses can sell their credits for a price between the credit's maximum value and the business's income tax liability. For example, if a firm owes $4,000 of federal income taxes but has a credit worth $7,000, it can sell the credit to a second firm for $6,000. In this example, the first firm gains $2,000 (because it pays an additional $4,000 in taxes but receives $6,000 in cash), while the second firm gains $1,000 (because it buys the credit for $6,000 but reduces its taxes by $7,000). Second, whereas traditional

tax credits are only claimed after firms file their taxes, transfers may occur at any time, starting with the year the tax credit is generated. Firms may make forward commitments to buy or sell credits in the future, however. Businesses in need of liquidity can sell their credits instead of taking out loans, which is especially important when interest rates are high.

According to IRS regulations, if a firm is deemed ineligible for a credit it has already sold, the liability falls on the purchaser of the credit. This could cause transferable credits to trade at less than their full value if buyers factor these potential losses into their purchasing decisions. It also explains why insurance coverage is built into most credit purchase agreements. In 2023, 74% of credit transfers included insurance coverage for the buyer.

Research has found that transferred tax credits typically sold at 89 to 95 cents on the dollar in 2023 and at slightly higher values in early 2024. Trading values differed significantly based on deal size. In 2023, credits purchased for less than $10 million traded at 89 cents on the dollar, whereas purchases exceeding $100 million traded at an average of 95 cents on the dollar. It is not clear how much of the difference between the credits' sales prices and their maximum values was attributable to liability concerns, the preference for immediately available cash, or other factors.

The clean vehicle credit (IRC §30D) and the used clean vehicle credit (IRC §25E) are eligible for a special type of credit transfer from consumers to car dealers. Such transfers are discussed in CRS In Focus IF12570, *Clean Vehicle Tax Credit Transfers to Car Dealers*, by Nicholas E. Buffie.

Intersection of the Two Mechanisms

Entities eligible for direct pay cannot sell their credits, but the law does not ban them from buying credits and receiving direct payments for those credits. The IRS stated that such credit "chaining" could lead to "fraud and abuse" and opted to ban the practice in its final regulations.

Fiscal Costs

In its August 2022 cost estimate, the Joint Committee on Taxation (JCT) estimated that the federal government will issue $36 billion of direct payments over FY2022-FY2031 for the five credits shown in **Table 1**. The JCT stated that direct payments would be "negligible" for five other credits, and it did not provide cost estimates for the direct payment portions of the AFVRPC and the credit for qualified commercial clean vehicles.

The gross direct payment estimates in **Table 1** may slightly overstate the net costs of direct payments. This could occur, for example, if the direct pay provisions incentivize an untaxed entity to make a clean energy investment that otherwise would have been made by a taxable corporation. In this case, direct payments to the untaxed entity would merely displace traditional tax credits that would otherwise have been claimed by a taxable corporation. Although JCT's dynamic scoring model includes such displacements in its total cost estimates (shown in the "Total Costs" column), the direct payment estimates do not distinguish between new costs incurred due to direct pay and costs shifted from traditional credits to direct pay. If the direct payment mechanism were repealed, the JCT would presumably estimate the net savings to the government to be less than the projected amount of direct payments issued.

The JCT has not published estimates of the fiscal costs of credit transferability.

Table 1. Statutory Cost of IRA Direct Cash Payments

Dollars in billions, FY2022-FY2031

	Direct Payments	Total Costs	Direct Pay Share
Advanced Manufacturing Production Credit	$14.7	$30.6	48.0%
Zero-Emission Nuclear Power Production Credit	$14.4	$30.0	48.0%
Clean Hydrogen Production Credit	$5.3	$13.2	40.4%
Credit for Carbon Oxide Sequestration	$1.6	$3.2	48.0%
Clean Electricity Production Credit	$0.03	$11.2	0.2%

Source: Joint Committee on Taxation.

Notes: The credit for carbon oxide sequestration predated the IRA, and the estimate in this table only includes costs incurred under the IRA. The JCT estimated in its 2020 tax expenditures report that the credit would cost $0.1 billion over FY2020-FY2024.

Application to Other Issue Areas

Only certain energy tax credits are eligible for direct payments and transferability. There are various credit-specific reasons why these mechanisms may help users and producers of "clean energy." For example, school districts have begun using direct payments to finance solar panel installations and electric bus purchases. Similarly, because large electricity providers often make large up-front investments when they are still unprofitable, they are eligible for large nonrefundable tax credits (IRC §§48, 48E) precisely when they cannot make use of them; however, transferability helps these providers by letting them sell their credits to other firms.

Going forward, Congress could consider changing which credits are eligible for direct payments and transfers. On the one hand, if these mechanisms prove effective at increasing clean energy investment, Congress could expand them to other parts of the tax code, such as to housing. On the other hand, if these mechanisms prove unexpectedly expensive, Congress could limit or eliminate them in an effort to decrease the federal budget deficit.

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