

Direct pay: an uncapped promise of the Inflation Reduction Act

The Inflation Reduction Act of 2022 (IRA) is a sea change in U.S. climate policy. At \$369 billion,¹ it stands as the largest one-time public investment in decarbonization in U.S. history and is already shaping large-scale investment planning for energy generation, storage, and transmission. A preliminary analysis by Princeton University's REPEAT project found the law stood to reduce emissions 42 percent from 2005 levels,² echoing similar analyses by the Rhodium Group³ and Energy Innovation.⁴ However, the IRA provides us with the opportunity to generate even more investment into clean energy and build out a robust publicly owned power system. The direct pay provisions of IRA §6417 allow tax exempt entities such as state and municipal governments to receive tax credits as direct transfers from the Internal Revenue Service (IRS). These direct pay provisions create new opportunities for public outlays on energy generation while having no formal cap on how much the government will spend through 2032.

Direct pay funded programs can play a catalytic role in seeding new public-sector capacity for planning and investing in large-scale clean energy projects nationwide. It creates the opportunity for a reorganization in how clean energy is developed in America. Prior to the IRA, only private entities could claim federal clean energy tax credits. As a result, our public entities and agencies had limited options for developing these clean power sources themselves. This report describes direct pay, discusses its implications for energy project financing and public entities, and points toward several possibilities for a robust and successful direct pay implementation over the next decade.

Section I: Direct pay 101

Prior to the IRA, only private developers could access the Investment and Production Tax Credits (ITC and PTC). For a developer to access the full value of the tax credit, they would require a massive

¹ Senate Democrats. *SUMMARY: THE INFLATION REDUCTION ACT OF 2022*. Available at: https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_one_page_summary.pdf. p 1.

² Jenkins et al. 2022. Preliminary Report: The Climate and Energy Impacts of the Inflation Reduction Act of 2022. ZERO LAB. Available at: https://repeatproject.org/docs/REPEAT_IRA_Preliminary_Report_2022-09-21.pdf. p. 7.

³ Larsen et al. 2022. *A Turning Point for US Climate Progress: Assessing the Climate and Clean Energy Provisions in the Inflation Reduction Act*. Rhodium Group. Available at: <https://rhg.com/research/climate-clean-energy-inflation-reduction-act/>.

⁴ Mahajan et al. 2022. *MODELING THE INFLATION REDUCTION ACT USING THE ENERGY POLICY SIMULATOR*. Energy Innovation. Available at: <https://energyinnovation.org/publication/updated-inflation-reduction-act-modeling-using-the-energy-policy-simulator/>. p. 2.



income tax liability. If they owed a smaller amount in taxes relative to their credit-eligible investments, developers would be unable to access the full value of the credit. The workaround to this problem was, and is, the tax credit equity market. Developers could transfer credits to an investor in exchange for receiving the monetary value of the credit plus additional tax benefits (such as accelerated depreciation—a provision that allows developers to factor the decline in value of energy projects into their taxes at an accelerated rate, meaning that projects can be paid off more quickly and easily).⁵ The investors—most often large financial institutions—have much higher tax liabilities than clean energy developers, allowing them to capture the full value of the credit and pay a discounted value of the credit to the developer as cash.

There are four major drawbacks to the use of tax equity markets:

1. Participants in tax equity markets have larger tax liabilities, but those liabilities are still limited. This capped the theoretical “maximum” disbursement from the tax credits and raised financing costs if too many projects vied for a small number of tax equity partners. The tax equity market is concentrated. Between 2015 and the first half of 2021, three banks—Bank of America, JP Morgan, and US Bank—accounted for 57 percent of the total wind and solar capacity additions financed through tax equity.⁶
2. Tax equity financing is procyclical. Earnings decline in periods of weaker economic activity, lowering the tax liabilities of large financial institutions alongside those of everyone else.⁷ This meant less room to monetize credits for potential projects as well as a backlog of projects awaiting tax equity financing if financial institutions ever became hesitant to lend—at the time when large scale, government supported investment is needed the most.⁸
3. The financial institutions monetizing tax credits do so at a discount. In other words, tax credit equity deals are not 1-1 exchanges of tax credits for cash. Instead, financial institutions take a cut of the credit value by paying partners only a percentage of the total value of their eligible credits. Credit Suisse estimates that demand for tax equity financing is greater than the pool of

⁵ Congressional Research Service. 2011. *ARRA Section 1603 Grants in Lieu of Tax Credits for Renewable Energy: Overview, analysis, and Policy Options*. Available at: <https://crsreports.congress.gov/product/pdf/R/R41635>. p. 16.

⁶ Jiang et al. 2022. *US Inflation Reduction Act: A Tipping Point in Climate Action*. Credit Suisse. p. 19-20.

⁷ 1) Milko, J. 2021. “Direct Pay: Tackling Clean Energy’s Tax Equity Troubles.” Third Way. Available at: <https://www.thirdway.org/memo/direct-pay-tackling-clean-energys-tax-equity-troubles>; 2) Congressional Research Service. 2011. *ARRA Section 1603 Grants in Lieu of Tax Credits for Renewable Energy: Overview, analysis, and Policy Options*. Available at: <https://crsreports.congress.gov/product/pdf/R/R41635>. p. 15.

⁸ 1) Milko, J. 2021. “Direct Pay: Tackling Clean Energy’s Tax Equity Troubles.” Third Way. Available at: <https://www.thirdway.org/memo/direct-pay-tackling-clean-energys-tax-equity-troubles>; 2) Meyer, G. 2020 “US renewables look to plug funding gap as pandemic hits tax incentives.” Financial Times. Available at: <https://www.ft.com/content/f54cd9b7-eee8-4a45-b0bb-f441960a5359>; 3) Gregory Meyer. 2020. “US renewables look to plug funding gap as pandemic hits tax incentives.” Financial Times. Available at: <https://www.ft.com/content/f54cd9b7-eee8-4a45-b0bb-f441960a5359>.

eligible capital to such an extent, that investors are often able to take as much as 15 cents of every dollar of tax credits provided by the Federal government.⁹

4. Tax-exempt entities (federal agencies, state and local governments, tribal governments, and nonprofit organizations) could not access the tax credits at all. Tax equity markets were not a workaround for these entities. This meant tax-exempt entities wishing to invest in clean generation faced a substantial cost disadvantage relative to for-profit competitors, limiting the growth rate of clean energy development writ large and public-sector owned and operated clean energy development specifically.

Box 1. On different types of energy entities.

This report distinguishes between multiple types of entities investing in energy projects. These include (but are not limited to):

1. **Utilities.** A company owning and operating facilities used for generation, transmission, or distribution of electric energy¹⁰ whose investments, rate of return, and consumer rates are subject to regulation by a commission or analogous public authority.
2. **(Private) Developer.** A private (for-profit or tax-liable) firm investing in the construction of new energy projects. The investments are recouped either through power purchase agreements or through sale into wholesale energy markets.
3. **Public Developer.** A publicly-owned and operated entity with its own budget, autonomous decision-making authority, and separation from day-to-day appropriations. Public developers can be spun off an existing agency, operate within agencies, or as an unaffiliated public enterprise. They invest in the construction of new energy projects for the purposes of making a return that can be channeled into additional investments, subsidies to consumers, or other public purposes.
4. **Electric cooperatives.** Not-for profit power suppliers that are owned and operated by their participating membership.

⁹ Jiang et al. 2022. *US Inflation Reduction Act: A Tipping Point in Climate Action*. Credit Suisse. p. 19.

¹⁰ “Electric utility company.” From 42 USC § 16451(5). Text available at:

https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=42-USC-102165177-0-834541452&term_occur=1&term_src=title:42:chapter:149:subchapter:XII:part:D:section:16451



Per IRA §6417, Tax-exempt organizations can now receive the full-value of the credit they are eligible for as a direct payment from the federal government.¹¹ Eligible entities include:¹² any organization exempt from paying federal taxes (nonprofits like universities or community institutions); any state or political subdivision thereof (local governments, potentially state and local agencies); the Tennessee Valley Authority; tribal governments Alaska Native corporations; and rural electric cooperatives. For example, direct pay would allow a city or town building utility-scale solar to receive 30 percent of the cost basis for facilities paying prevailing wages and meeting registered apprenticeship requirements through the Clean Electricity Investment Credit.¹³ A further 10 percentage points of funding is possible for property placed in an “energy community” and another 10 percentage points is available through a domestic content bonus for projects using certified steel, iron, and manufactured products.¹⁴ **That means the Federal government could cover between 30 and 50¹⁵ percent through direct payments for ITC qualifying projects taken on by tax-exempt entities.** But this is not the only credit tax-exempt entities are eligible for: a list of credits eligible for direct pay is below.¹⁶

1. Alternative Fuel Refueling Property Credit (§30C)
2. Production Tax Credit (§45, §45Y)
3. Credit for Carbon Oxide Sequestration (§45Q)
4. Zero-Emission Nuclear Power Production Credit (§45U)
5. Credit for Production of Clean Hydrogen (§45V)
6. Credit for Qualified Commercial Clean Vehicles (§45W, tax-exempt entities only)
7. Advanced Manufacturing Production Credit (§45X)
8. Clean Fuel Production Credit (§45Z)
9. Investment Tax Credit (§48, §48E)
10. Advanced Energy Project Credit (§48C)

Note that tax liable entities are eligible for direct payment only for the Section 45Q, 45V, and 45X credits.¹⁷

¹¹ U.S. Congress. 2022. “Sec. 6417. Elective Payment of Applicable Credits.” In *H.R. 5376 - Inflation Reduction Act of 2022*. Available at: <https://www.congress.gov/bill/117th-congress/house-bill/5376/text>.

¹² Ibid.

¹³ Congressional Research Service. 2022. *Tax Provisions in the Inflation Reduction Act of 2022 (H.R. 5376)*. Available at: <https://crsreports.congress.gov/product/pdf/R/R47202>. P. 19.

¹⁴ Ibid, p. 19.

¹⁵ In addition to the bonuses for projects in energy communities and the certified content bonus for domestic steel, iron, and manufactured bonus, projects receiving a capacity allocation for “environmental justice solar and wind capacity” may be entitled to additional bonuses, such as for being part of a low-income residential building project or qualified low-income economic benefit project. Source: Congressional Research Service. 2022. *Tax Provisions in the Inflation Reduction Act of 2022 (H.R. 5376)*. Available at: <https://crsreports.congress.gov/product/pdf/R/R47202>. P. 20.

¹⁶ The list is taken verbatim from: Department of the Treasury. FACT SHEET: Four Ways the Inflation Reduction Act’s Tax Incentives Will Support Building an Equitable Clean Energy Economy. Available at: <https://home.treasury.gov/system/files/136/Fact-Sheet-IRA-Equitable-Clean-Energy-Economy.pdf>.

¹⁷ BakerHostetler. 2022. “What’s in It for Me: The Inflation Reduction Act’s Clean Energy Tax Credits.” Available at: <https://www.bakerlaw.com/inflation-reduction-act-clean-energy-tax-credits>.



Direct pay had a precursor in the American Recovery and Reinvestment Act's \$1603 cash grants program, which allowed energy properties to receive a one-time cash grant in lieu of tax credits equivalent to 30 percent of the cost basis for specified projects.¹⁸ It was created specifically to address the diminished investor demand for monetizing tax credits during the late 2000s recession¹⁹ and was available to any tax liable eligible claimants of the ITC and PTC.. The Treasury Department's final overview of the program indicates it provided \$26.2 billion in funding to \$94.3 billion of eligible projects and installed 34.6 GW of primarily wind and solar capacity.²⁰

There was also anticipation before the passage of IRA that direct pay for for-profit entities would be part of the Build Back Better legislation. The original House and Senate versions of Build Back Better from December 2021 both enabled a wider eligibility of direct pay.²¹ The exclusion of direct pay for tax-liable entities from most IRA credits (particularly the ITC and PTC) means the continuation of tax equity market financing in for-profit energy development. Though the IRA does include §6418, which allows eligible taxpayers (tax exempt entities eligible for direct pay cannot transfer the credits²²) to transfer the benefits of the credit to another eligible taxpayer for a cash payment instead.²³ This should ease some of the reliance on tax equity markets by expanding the pool of eligible investors.²⁴

A note on Federal rulemaking and implementation: The previous section confined its description of direct pay to legislative text and associated descriptive or research work that has been published since IRA's passage. However, the details on implementation as well some of the potential benefits highlighted by subsequent sections of this report will depend on Federal rulemaking from the Internal

¹⁸ Congressional Research Service. 2011. *ARRA Section 1603 Grants in Lieu of Tax Credits for Renewable Energy: Overview, analysis, and Policy Options*. Available at: <https://crsreports.congress.gov/product/pdf/R/R41635>. p. 2.

¹⁹ Ibid, p. 15.

²⁰ U.S. Department of Treasury. 2018. *Final Overview of the \$1603 Program*. Available at: <https://home.treasury.gov/system/files/216/P-Status-overview-2018-03-01.pdf>. p. 1-3.

²¹ 1) U.S. Congress. 2021. "Senate Finance Committee print of the Build Back Better Act, released on December 11, 2021." Accessed via pdf on Capitol Tax Partners. Available at:

<https://static1.squarespace.com/static/5d07999ccf8c9100016d75d2/t/61b522b42b70670cd4f0b0fd/1639260854276/12.11.21+Build+Back+Better+Finance+Text.pdf>. p. 393. 2) U.S. Congress. 2021. "House-passed Build Back Better Act (BBA) Legislative Text, H.R. 5376, Passed the House on November 19, 2021." Accessed via pdf on Capitol Tax Partners.

Available at:

<https://static1.squarespace.com/static/5d07999ccf8c9100016d75d2/t/61b5214cc904e8558b459925/1639260494058/11.19.2021+House+Passed+BBB.pdf>. p. 1370.

²² 1) EPA. "The Inflation Reduction Act." Available at: <https://www.epa.gov/green-power-markets/inflation-reduction-act>;

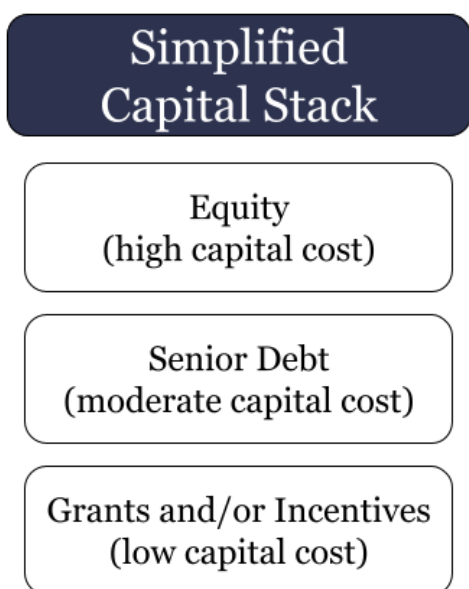
2) Burton, D., and H. Lefko. 2023. "Q&A on the Inflation Reduction Act." Norton Rose Fulbright. Available at: <https://www.projectfinance.law/tax-equity-news/2022/august/qa-on-the-inflation-reduction-act/>. Accessed February 19, 2023.

²³ U.S. Congress. 2022. "Sec. 6418. Transfer of Certain Credits." In *H.R. 5376 - Inflation Reduction Act of 2022*. Available at: <https://www.congress.gov/bill/117th-congress/house-bill/5376/text>.

²⁴ Jiang et al. 2022. *US Inflation Reduction Act: A Tipping Point in Climate Action*. Credit Suisse. p. 12; 19.

Revenue Service (IRS) and the Department of the Treasury. CPE filed comments²⁵ with the IRS in response to a request for comment in November 2022.²⁶ We noted that significant restrictions on the use-cases of the credits (restricting partnerships), over-complicating the application process, or placing undue burdens on public enterprises relative to their private counterparts could diminish the effectiveness of direct pay. Section II and III discuss the prospective benefits of getting direct pay right.

Section II: Direct pay and the capital stack



To understand how valuable direct pay can be to potential recipients, it is important to describe how it fits in with existing financing models for renewable energy generation—in other words, how does it fit into the capital stack? A capital stack refers to the mix of financing and funding that pays for investment in a capital project.²⁷ It is usually displayed as a vertical diagram which places different financing instruments in order of their financing cost (aka interest, rate of return, cost of capital).

A project’s weighted average cost of capital (WACC) refers to an average of the interest rates of each financing instrument utilized weighted by their percentage of the total capital stack. All else equal, a project should want their financing mix to involve more financing instruments from lower in the capital stack. These instruments—grants,

Figure 1. Simplified capital stack.

government revenues, fixed-rate loans with longer maturity—have much cheaper financing costs and using more of them results in a cheaper WACC. Direct pay qualifies as one of these desirable financing instruments. Direct pay will be disbursed either through a regular stream of payments or one or

²⁵ Lala, C., P. Williams, Y. Feygin. November 2022. *Guidance on the Direct Payment of the Inflation Reduction Act’s Clean Energy Tax Credits*. Center for Public Enterprise. Available at:

<https://www.publicenterprise.org/reports/comments-on-guidance-for-direct-pay>.

²⁶ IRS. October 2022. “IRS asks for comments on upcoming energy guidance.” Available at:

<https://www.irs.gov/newsroom/irs-asks-for-comments-on-upcoming-energy-guidance>.

²⁷ Colenbrander, S., M. Lindfield, J. Lufkin, N. Quijano. 2018. “Financing Low-Carbon, Climate-Resilient Cities.” Coalition for Urban Transitions: A New Climate Economy Special Initiative. Available at:

https://www.researchgate.net/figure/Illustrative-capital-stack-showing-how-different-sources-of-finance-can-be-combined-by_fig2_323560614, p. 26

multiple larger lump-sums.²⁸ Projects can use regular payments for cash outflow (reducing revenue requirements) or secure cheap bridge financing against scheduled lump sums.²⁹

In either case, the energy project is responsible for a much lower “effective WACC” relative to the WACC it would face without direct pay. This means a local government investing in owned-and-operated solar generation will need to secure additional financing of a much smaller share of the total investment (public and private investment combined). To the extent the local government has cheaper sources of financing (municipal bonds, green bank loans, other government grants available), the WACC on its project will be much smaller. See an illustrative example of simplified capital stacks that direct pay enables, below.

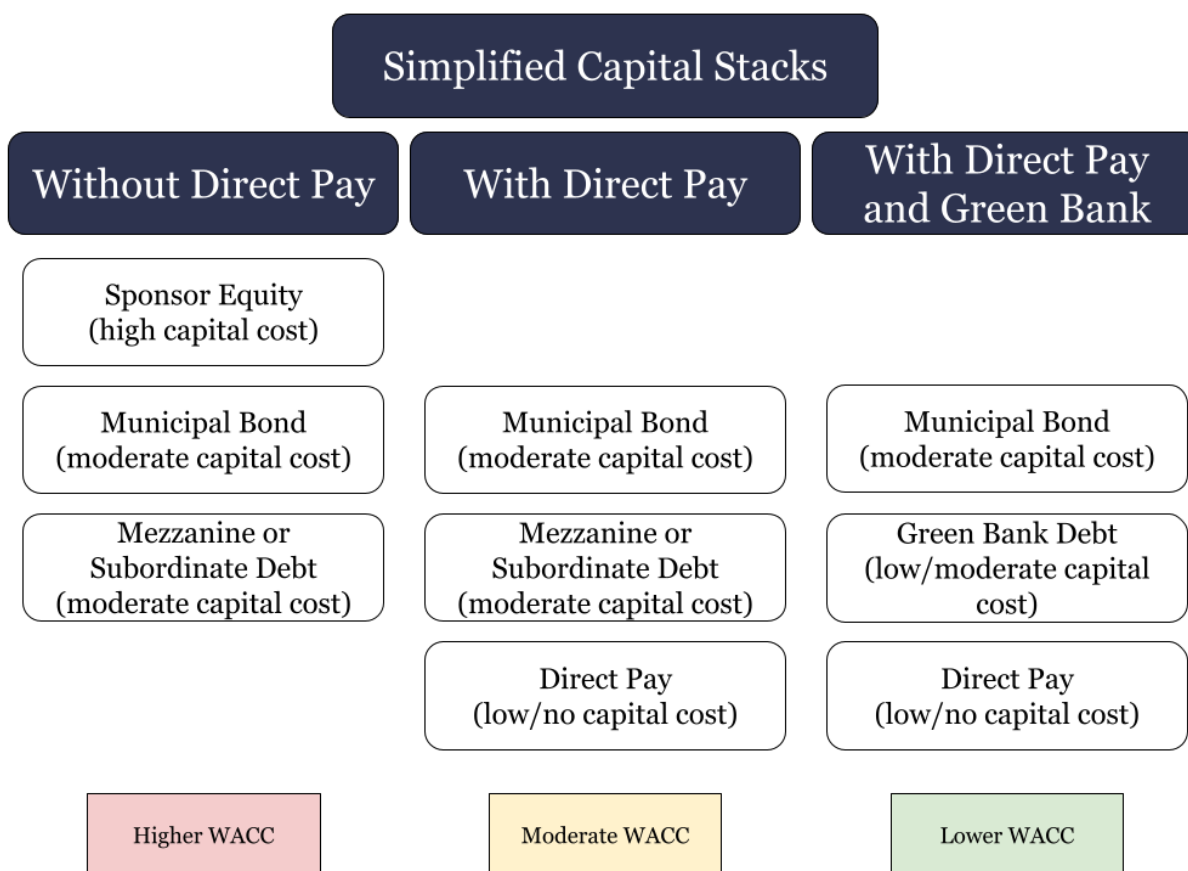


Figure 2. Simplified example capital stacks showing how direct pay and green bank lending help to lower the average cost of capital for clean energy projects.

²⁸ The precise disbursement method chosen for direct pay will be the subject of upcoming federal rulemaking.

²⁹ To the extent there is a non-zero cost for bridge financing, disbursing direct pay as one lump-sum would result in a lower project WACC. However, there are also circumstances in which bridge financing could be floated by a project partner at essentially zero cost relative to other financing they provide over and above the direct pay contribution—in which case the effective WACC would be identical in either a stream of payment disbursement model or a lump sum disbursement model.



The first stack on the left illustrates a plausible capital stack for a municipality financing of *owned and operated* solar generation before the IRA (no direct pay, limited green bank loans). The second illustrates the municipality’s capital stack with direct pay access to the clean energy tax credits. Finally, the third illustrates a capital stack with both direct pay and increased green bank financing made possible by another IRA provision: the Greenhouse Gas Reduction Fund. As the share of IRA energy-financing increases, the WACC drops substantially as the municipality reduces its reliance on more expensive mezzanine debt, sponsor equity, or other forms of marketable debt.

Direct pay’s cost benefit is immediately visible. A large percentage of project financing can be covered immediately by the Federal government and overall project financing is made cheaper. This opens other vital benefits for energy development more generally, the capacity of state and local governments to undertake development policies of their own, and the potential to win additional investments and emissions reductions out of the IRA.

Section III: The economic benefits of direct pay

This section discusses the benefits of direct pay specifically to investment in publicly owned- and operated-energy generation. Publicly owned- and operated-generation refers to any energy project developed and operated by a public agency or other instrumentality of a local, tribal, state, or federal government. These could be municipal governments, economic development corporations, public utility districts³⁰, or federal agencies like the Bonneville Power Administration. They could also include a new class of entities known as public energy developers—state owned energy firms that are autonomous from day-to-day political processes, whose mandates include public goals, can access the government’s fiscal capacity for financing, but that strive to operate on a positive cash flow basis.³¹ Direct pay offers these actors significantly more flexibility to shape the development of decarbonization in their respective jurisdictions.

Project financing and new market creation: As indicated in Section II, direct pay makes investment in decarbonization technologies cheaper for any tax-exempt filer. It also opens new opportunities for public entities to engage financial mechanisms in service of public capacity expansion. Nick Chaset, CEO of East Bay Community Energy (EBCE), noted that the inability to monetize the ITC or PTC prevented EBCE from owning and operating its own generation.³² Instead, they primarily operate by entering long term power purchase agreements. Not only would direct pay lower those costs, but it

³⁰ Not-for-profit, community-owned utilities in Washington State that provide electricity, water, sewer, and telecommunication services. They are owned and regulated locally. Source: Washington Public Utility Districts Association. “Frequently asked questions.” Available at: <https://www.wpuda.org/faqs>.

³¹ Depending on the conditions placed on their operation, public energy developers act for all intents and purposes as any other energy development firm. The exception is they are owned by the state, can take on investments commensurate with the state’s risk appetite, and are not subject to the same dividend or profit requirements as private firms (unless they enter into specific agreements with other entities).

³² Twitter thread by Nick Chaset (@ebce_ceo) on August 5, 2022. Available at: https://twitter.com/ebce_ceo/status/1555586225523740677.



would also enable EBCE to use municipal bonds (which are cheaper than comparable corporate bonds) to further reduce the WACC of public power projects.³³

In addition, the use of municipal bonds could amortize project costs over a longer period (30 to 40 years instead of 15 to 20 years), further reducing quarterly cash outflow requirements and aligning repayment terms with the expected life of the clean energy project.³⁴ The cost and maturity advantages of municipal bonds have always existed, but the lack of access to tax credits locked actors like EBCE out of energy markets, leaving them solely as consumers of power rather than producers. By doing away with that discrepancy, direct pay opens an avenue to increasing competition and supply within local energy markets, especially those that lack options for power purchase agreements or local investments outside of the local utility. Allowing entities like EBCE to produce their own power would also reduce consumer costs by directly increasing electricity supply and by allowing EBCE to subsidize costs using profits from the sale of that power.

Scope for planning and development of public capacities: If large public entities seize the opportunity to plan utility-scale energy projects not just for their local needs, but to sell into wholesale markets, then those entities would by necessity be de facto shaping the energy mix of their respective state or region towards cleaner alternatives. To maximize their impact, public entities would have to develop capabilities to plan large scale projects, structure purchases of inputs and hiring of labor, arrange long-term power purchase agreements, and manage the challenges of interconnection to the distribution and transmission systems. They will have to consider how those resources will operate in the context of the grid’s current resource mix and constraints it faces to resilient operation—the grid topology³⁵—and what resources are right to invest in and when. As these public entities grow larger (or if they start out as large-entities in their respective region like TVA or BPA), they will be able to shape the medium- and long-term planning horizons of contractors, suppliers, energy consumers, and other entities with a stake in energy markets—de-risking capital expenditures in a whole range of energy-adjacent and energy-specific sectors.

The public sector as an investment opportunity: Direct pay makes tax exempt entities (particularly public agencies and their projects) into investment opportunities for private entities, either as potential project partners (see “competitive advantage” and “project financing and new market creation”) but also as generators of new investment assets. Even if a nonprofit or tax-exempt entity does not have sufficient capacity to develop, own, and operate its own energy project, its credit eligibility gives it a leverage in project finance negotiations that it would not have had before. It can use its cost-free access to monetization to secure partnerships with developers who have capacity but may have been put off by tax equity markets or were unable to transfer the credits. In this sense, direct pay reverses the dynamics of many public-private partnerships.

³³ Ibid.

³⁴ Ibid.

³⁵ Green, M. 2023. “The Case for Grid Thought.” Center for Public Enterprise. Available at: <https://www.publicenterprise.org/blog/case-for-grid-thought>.



Moreover, a public agency need not partner solely with entities who will be equity holders for the life of a project. Another way to shift project capital stacks is for the agency to create a structured debt project (including by securitizing the cash flows of multiple holdings) and buy out its project partners once the project reaches a certain stage of maturity. Direct pay will have helped get the project off the ground, and the use of financial instruments (particularly municipal debt) will allow the public entity to create a secure cash inflow from power purchases to pay off the resulting liability. Such deals are advantageous for two reasons. First they expand the pool of investors interested in partnering with public enterprises. Second, it further reduces the WACC by eliminating cash outflows on equity or mezzanine debt.

Box 2. Why invest in publicly owned and operated energy generation if utilities exist?

Not all utilities are direct pay eligible. In addition, direct pay offers public developers or agencies opportunities for business and productive partnership with community institutions and the private sector that would otherwise not be possible. For communities whose local utility or energy company is not making investments in cleaner energy, direct pay is an opportunity for the public sector to take a more active role and push energy investment in the right direction towards their local or state climate targets.

Lowering the WACC of clean energy projects opens up prospects for addressing cost issues to consumers. A lower WACC means that utilities can, and in many jurisdictions, must charge customers lower rates. Moreover, proceeds from the spread between market power purchase prices and the lower cost of capital could be re-invested by a public energy developer into additional energy projects and to cross-subsidizing below cost electricity rates for disadvantaged households. Future rulemaking and legislation could expand on this by having Federal GSEs, state green banks, or other entities purchase standardized debt products from tax-exempt entities or partnerships involving them—thereby creating a new low cost of financing for public projects.³⁶ In effect, it could allow public agencies to accelerate the rate of capital investment using a limited capital base.

Enhancing the effectiveness of the Inflation Reduction Act: Direct pay does not limit the usage of other opportunities offered by the Inflation Reduction Act, most notably green banking finance supercharged by the Greenhouse Gas Reduction Fund. Crucially, it is also uncapped until January 1, 2033. That means there is no limit on the amount public entities can draw from direct pay if they can plan and execute the required investment projects. If policymakers can create circumstances that make direct pay easy to access, provide technical assistance to state and local governments with respect to

³⁶ Feygin, Y., P. Reddy. 2021. *Building Our Municipalities Markets Better: The Case for a GSE for Municipal Finance*. Berggruen Institute. Available at: <https://www.berggruen.org/ideas/articles/building-our-municipalities-markets-better-the-case-for-a-gse-for-municipal-finance/>.



energy project development and financing, and clarify the uncertainty around direct implementation, they will lay the groundwork for usage to expand.³⁷ There is already research indicating that prevailing projections underestimate IRA's fiscal impact. Research by Credit Suisse³⁸ indicates that total public outlays will be closer to \$800 billion—nearly double the projected Congressional Budget Office's total due to the uncapped nature of the tax credits.³⁹ Total public and private investment together could be as high as \$1.7 trillion.⁴⁰ Follow-through could and should aspire to get these public and private investment figures (and as a result their accompanying emissions reductions) even higher. Focusing on this challenge must also inspire a welcome shift towards the barriers that hold back rapid buildups of our energy infrastructure.

Section IV: Next steps

Direct pay carries enormous promise for a renaissance in American public energy production. If done correctly, the spillovers on private industry and state capacity⁴¹ will benefit the United States for decades to come. However, four major challenges still face direct pay. This section describes those challenges and future efforts by CPE to address them.

1. **Implementation.** It is critical that Federal rulemaking not prohibit the opportunities described in Sections II and III. Policymakers, potential beneficiaries, researchers and advocates are all waiting for Federal guidance to plan projects. Public rulemaking should answer their questions and concerns as expeditiously as possible. On substance, it should default to maximum flexibility and administrative simplicity for tax-exempt entities—particularly public entities—who access direct pay. It should not unduly restrict partnerships, arrangements, or creative uses of the credit by tax-exempt entities. CPE monitors developments in Federal rulemaking and will respond as needed to any future requests for guidance or comment.
2. **Awareness.** Direct pay is not a well-known element of IRA tax credits. Tax exempt entities who do not know about direct pay or how it can be used will not be in a place to determine if it is right for them or to plan its most effective usage. CPE will provide assistance to interested parties to 1) raise direct pay awareness; 2) iterate on relevant policy questions; and 3) gather feedback, concerns, questions, and potential use cases to inform further work.
3. **Incompleteness.** Direct pay is currently restricted to tax-exempt entities, despite originally being proposed and piloted for for-profit entities. Any entity that could conceivably invest in

³⁷ Even though it is capped, direct pay therefore approximates an investment permutation of what Nathan Tankus called for with respect to energy Covid fiscal relief: an uncapped program whose benefits are the legally entitled to those with qualifying projects. Source: Tankus, N. 2020. "The Coronavirus Depression Requires A New Approach to Budgeting." Notes on the Crisis. Available at: <https://nathantankus.substack.com/p/the-coronavirus-depression-requires>.

³⁸ At the time of writing, Credit Suisse is being acquired by UBS.

³⁹ Jiang et al. 2022. *US Inflation Reduction Act: A Tipping Point in Climate Action*. Credit Suisse. p. 1.

⁴⁰ Ibid.

⁴¹ Defined here as the ability of the state to carry out the various functions and operations assigned to it or expected of it.



energy generation should have access to the financial incentives used by the United States government to promote investment: for profit entities, non-profits, government agencies, and others. Furthermore, those claiming credits should be able to access other benefits of investment tax benefits for their energy projects: including accelerated depreciation. Direct pay should also be extended beyond 2032, with modifications to account for new technologies that might emerge in the first decade of the IRA. CPE will continue monitoring developments and advocating for expansion of the direct pay framework.

4. State capacity. There will be a sizable gap in the first years between public agencies wishing to take on energy investments and their capabilities. Many local and state governments do not have experience undertaking investment of this type. Due to its novelty, municipal and state fiscal rules may require further analysis or clarification to treat direct as federal transfers. Governments and nonprofits may not know how to file the necessary forms, reach agreements with private counterparties, or otherwise conduct planning.

For many agencies, doing such work in-house will not make sense and bringing in partners will be the wisest course of action. For other governments, it may be advantageous to create special purpose vehicles. Others will develop new agencies or work through existing economic development corporations, housing authorities, or via their respective green banks and utilities. Governments should also be investing in resources to help nonprofit actors take advantage of these credits: either independently or in partnership with the state. The types of resources states need must be carefully thought through and nurtured. We will continue working with prospective public and private beneficiaries of direct pay and seeking practitioners' understanding of the capacities they need, legal obstacles or barriers to further action, and policy changes that would facilitate the deployment of public investment.

Concluding thoughts

Direct pay usage will not grow exponentially right from the beginning. Building state capacity for owning and operating clean energy will take time, and the details of implementation will matter for success. Experiments with public energy business models, new capacities available to public agencies, and the planning of further investment in clean generation is vital to ensuring that each advancement can build on the next. Scale and efficiency should be prioritized. If done right, direct pay can fertilize a new generation of public sector development and growth of state capacity in the United States as a basis for building on the outstanding achievement that is the Inflation Reduction Act.