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Schumer and Manchin's Inflation Reduction Act Includes Significant Tax Incentives to Combat Climate Change

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On July 27, 2022, in a surprise to most people in Capitol Hill and across the country, Senator Manchin and Majority Leader Schumer released a budget reconciliation bill dubbed the Inflation Reduction Act (the "Bill"), which sets aside $369 billion to combat climate change, $300 billion in deficit reduction and will allow Medicare to negotiate prescription drug pricing.

The Bill has significant momentum, and Democrats in Congress are racing to pass it in the coming weeks given concerns that the Bill may die if it is put on hold until after the August recess. Assuming the procedural hurdles around the budget reconciliation process are cleared, the Senate is expected to vote on the Bill this week. If it clears the Senate (which will require all 50 senators who caucus with Democrats to vote in favor), the House is likely to return from its August recess to pass the Bill.

Below are highlights of some of the key proposals on renewable energy incentives included in the Bill.

ITC and PTC

The Bill extends the availability of the investment tax credit ("ITC") and production tax credit ("PTC") for certain renewable technologies that begin construction prior to the end of 2024. The ITC for solar would be reinstated to its historic full rate of 30% of eligible costs incurred in completing a solar project, while the PTC for wind would no longer be subject to a phase-down (i.e., 100% PTC availability over a 10-year-period for wind projects placed in service in 2022 or later) so long as certain wage and apprenticeship requirements are satisfied. The PTC amount currently adjusted for

inflation is $26 / MWh. Projects that commence construction no more than 59 days after the Secretary publishes guidance on these requirements will be grandfathered and exempt from the wage and apprenticeship requirements. However, for projects claiming the PTC, the wage and apprentice requirement must be satisfied with respect to any alteration or repair of the project that occurs during the entire 10-year PTC period.

After expiration of the ITC and PTC, solar and wind projects and other technologies will transition to a technology neutral credit with rules very similar to the PTC and ITC rules, but with a regime that effectively further extends those credits through the later of 2033 or the first calendar year following the year when the IRS determines that annual greenhouse gas emissions from U.S. electricity production have fallen by at least 75% as compared to the comparable emissions in 2022. After this point the credits will begin to phase out.

The scope of ITC eligible property was also expanded to include standalone energy storage facilities, certain biogas power generation projects and microgrid controllers. The availability of the ITC for standalone storage facilities is a significant development because current law is often interpreted to require storage to be co-located with a solar project to be eligible for tax credits, and requires the storage to be 100% charged from a solar project in order to claim a full ITC. This new development will allow for significant expansion of storage projects in geographic areas where energy storage is needed for grid reliability, but which may otherwise not be appropriate locations for a solar PV system. Energy storage technology is defined broadly to include property that receives, stores and delivers energy for conversion to electricity (or, in the case of hydrogen, that stores energy) and has a nameplate capacity of not less than five kilowatt hours and thermal energy storage property.

Solar projects will also be permitted to claim a PTC in lieu of an ITC if construction begins by the end of 2024.

It is worth noting that the Bill does not include an ITC for transmission assets, which was part of the proposed (but never enacted) Build Back Better Act.

Domestic Content / Energy Communities

Projects that are eligible for the ITC or PTC that meet certain domestic content requirements will be eligible for additional tax credits. Assuming that the wage and apprentice requirements are met, ITC projects will be entitled to claim an additional ITC in the amount of 10% of eligible costs, while PTC projects will be eligible for an

additional 10% PTC based on the amount of PTCs generated. Similarly, projects that are located in certain communities (i.e., historically coal communities, certain brownfield sites and areas with significant employment from coal, oil, or natural gas) will be eligible for an additional 10% supplement on top of the existing ITC or PTC. Therefore, a solar project that meets the domestic content and community location requirements may be eligible for an ITC of up to 50%.

Domestic content requirements can be met if at least 40% (20% for offshore wind projects) of the total cost of manufactured products of the project is attributable to products and components that were produced or manufactured in the U.S.

Carbon Sequestration

The Bill extends the deadline for commencing construction on carbon sequestration projects to the end of 2032 to be eligible for carbon sequestration credits. The Bill also significantly increases the amount of tax credits for projects that meet certain wage and apprenticeship requirements as follows:

	Current Law	Bill*
$/Metric Ton (Carbon Utilized, e.g., enhanced oil recovery)	Up to $35	$60
$/Metric Ton (Carbon Not Utilized)	Up to $50	$85
Direct Air Capture (Carbon Utilized)	Up to $35	$130
Direct Air Capture (Carbon Not Utilized)	Up to $50	$180

*These rates will continue to adjust for inflation after 2025.

The Bill also relaxes the annual capture requirements for credit eligibility. The minimum annual carbon capture requirement is 1,000 metric tons for a direct air capture facility, 18,750 metric tons for an electricity generating facility with a capture capacity of at least 75% of the total carbon emissions from such facility and 12,500 metric tons for all other facilities.

Hydrogen / Aviation Fuel / Biodiesel / Renewable Natural Gas (Biogas)

Clean Hydrogen

The Bill creates a new 10-year PTC in an amount of up to $3/kg of qualified clean hydrogen produced after 2022, subject to meeting the same wage and apprentice requirements that apply to the ITC and PTC. To claim the full $3/kg, the hydrogen production must result in a lifecycle greenhouse gas emissions[1] rate of less than 0.45kg of carbon dioxide equivalent ("CO2e") per kilogram of hydrogen. However, qualified clean hydrogen that produces up to 4kg of CO2e per kilogram of hydrogen is still eligible for a partial credit, meaning blue hydrogen — hydrogen produced from natural gas but the emissions of which have been captured and stored through carbon capture and sequestration — may qualify for the credit as well. Existing facilities placed in service before 2023 that did not produce qualified clean hydrogen can be modified to produce qualified clean hydrogen and claim the credits. Taxpayers may also elect the ITC in lieu of the PTC. No credit will be allowed for any qualified clean hydrogen produced at a facility that includes carbon capture equipment for which a Section 45Q credit was claimed for any taxable year.

The Bill treats the use of electricity generated from renewable resources (claiming a PTC) for producing clean hydrogen as if it was sold to an unrelated party. This is significant because many developers have been considering utilizing their wind projects to power electrolyzers to produce "green hydrogen" — the term commonly used to refer to hydrogen produced by splitting water into hydrogen and oxygen using a renewable energy-powered electrolyzer. Under current law, however, the wind project would lose its eligibility for the PTC because the electricity would not be sold to an unrelated party, which is a requirement to claim the PTC.

Sustainable Aviation Fuel

The Bill creates a new sustainable aviation fuel credit. Qualifying sustainable aviation fuel must reduce lifecycle greenhouse gas emissions by at least 50%. The credit amount is equal to $1.25 per gallon plus an additional $0.01 for each percentage point above the 50% emissions reduction rate, for a maximum credit of $1.75 per gallon. This credit only applies to sales or uses of such qualified fuel before the end of 2024.

Biodiesel, Renewable Diesel and Alternative Fuels

The Bill extends the existing tax credit for biodiesel, renewable diesel and alternative fuels through the end of 2024. The Bill also extends the tax credit for qualified second generation biofuel mixtures through the end of 2024, which previously expired at the end of 2021.

Biogas Property

As mentioned above, the ITC is expanded to include qualified biogas property that starts construction by the end of 2024, which converts biomass into gas that consists of at least 52% methane, or is concentrated into gas that consists of at least 52% methane and, in each case, captures such gas for productive use rather than disposal via combustion.

Direct Pay / Transferability

Given the number of clean energy technologies supported by tax credits, there may not be sufficient tax equity available to monetize the tax benefits of all of the renewable projects in the market. To alleviate potential bottlenecks in the tax equity market, the Bill includes a concept of direct pay and the ability to transfer tax credits for cash.

Direct pay is generally only available to tax-exempt entities, including state or local governments and Indian tribal governments, but there is an exception for carbon sequestration credits (first five years starting with the year the property is placed in service, but only until 2032), clean hydrogen PTCs (first five years starting with the year the property is placed in service, but only until 2032) and certain advanced manufacturing PTCs (any five consecutive years during which qualifying production and sale occur, but only until 2032), which are available to all taxpayers.

Other taxpayers that are not eligible for direct pay will be permitted to exchange the tax credits with any unrelated party for cash. This type of transfer can be made for all or a portion of the applicable tax credits, and the cash proceeds from such sale will be exempt from tax. When a project is directly owned by a partnership, an election to transfer must be made by such partnership (i.e., not at the partner-level). The transferee is not permitted to further transfer the credits.

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1. Lifecycle greenhouse gas emissions will have the same meaning as set forth in Clean Air Act section 211(o)(1), 42 U.S.C. § 7545(o)(1), and will only include emissions through the point of production (well-to-gate), as determined under the most recent Greenhouse gases, Regulated Emissions, and Energy use in Transportation model (commonly referred to as the "GREET model.").↩

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Suggested Reading

- 02 August 2022 Press Release Kirkland Advises Antin on Acquisition of Wildstone
- 01 August 2022 Press Release Kirkland Advises Augment on US$85 Million Investment in Origo Energia
- 28 July 2022 Press Release Kirkland Represents Diversified Energy in Acquisition of Western Anadarko Assets from ConocoPhillips

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