Summary of house ways and means committee proposals related to the investment tax credit, production tax credit, and the carbon capture and sequestration tax credit

Introduction

On Friday, the House Ways and Means Committee Chairman released a proposed infrastructure financing and green energy bill as part of their ongoing work on the Build Back Better Act (the "**Bill**"). Below is a summary of major themes and takeaways, and the key proposals as related to clean energy, with comparisons to current law.

Principal themes

1. Expansion and extension of the: (1) Investment Tax Credit under section 48 ("**ITC**"); (2) Production Tax Credit under section 45 of the Code ("**PTC**"); and (3) Carbon Capture and Sequestration Credit under section 45Q ("**45Q Credit**"). Enactment of new credits, with a heavy focus on new technologies.
2. A direct payment option enabling taxpayers to take a cash payment from the government equal to the credit value, or access the tax equity market, is available for the PTC, ITC, 45Q Credit, credit for alternative fuel vehicle refueling property under Section 30C, and qualifying advanced energy project credit under 48C.
3. The credits are "tiered", meaning there is: (1) a base credit (generally 20% of the headline credit); (2) a "bonus" credit (generally 80% of the headline credit) conditioned on satisfying certain labor and wage requirements promulgated under the labor code; and (3) a domestic content credit that provides an additional tax incentive for incorporating American-made materials into a project (such materials "**Domestic Content**" and such credit the "**Domestic Content Bonus**").
4. All projects that elect to use direct pay and that are eligible for the Domestic Content Bonus, are penalized for not meeting Domestic Content requirements. ITC/PTC projects that do not elect to use Direct Pay merely do not receive the Domestic Content Bonus if they do not meet the Domestic Content requirements.
5. Projects that are currently under construction are seemingly eligible for increased credits under the current Bill.

Example of operation of the Bill provisions for an existing wind project

A wind project that begins construction in 2016 (eligible for a 100% PTC under current law) and is placed in service before 2023 appears to qualify for a 100% PTC (without having to analyze the continuous efforts concept), and the current Bill exempts this project from the labor and wage requirements because construction began prior to the Bill's enactment. If the project complies with certain Domestic Content requirements (discussed further under "*Domestic Content*"), then it may qualify for a 10% bonus credit. If, alternatively, construction started in 2021, then the credit before the passage of the Bill would be 60%. However, it appears a wind project that had qualified for a 60% PTC can delay its placed in service date until 2023 and instead qualify for a 100% PTC, and a 110% PTC if it satisfies the Domestic Content requirements, and be exempted from the labor and wage requirements.

If the wind project does not meet the Domestic Content requirements, the project does not qualify for the 10% bonus credit (ie it could still qualify for the regular 100% PTC if it meets the other requirements), but there is no penalty for failure to comply with the Domestic Content requirements unless the taxpayer wishes to elect to receive the value of its PTC as a cash payment (discussed further under "*Direct Pay*"). If a taxpayer wants to make use of this direct pay option for the full value of the credit, then it must comply with the Domestic Content requirements. Otherwise, the value of the credit it will receive as direct pay will be reduced for projects that start construction in 2024 with a phase down to 0% for projects that start construction after December 31, 2025.

It is unclear how any continuity requirement applies with respect to projects that started construction prior to enactment of the Bill because the start of construction deadlines will have been extended so dramatically.

Example of operation of the Bill provisions for an existing solar project

A solar project that begins construction in 2019 and is placed in service in 2023 will qualify for 30% ITC. If the project complies with certain Domestic Content requirements (discussed further under "*Domestic Content*") and satisfies the labor and wage requirements, then it will qualify for a 10% bonus credit. If the project complies with the Domestic Content requirements but does not satisfy the labor and wage requirements, then it will only qualify for a 2% bonus credit.

If the solar project does not meet the Domestic Content requirements, the project simply does not qualify for the bonus credit (ie it could still qualify for the regular 30% ITC if it meets the other requirements), but there is no penalty for failure to comply with the Domestic Content requirements unless the taxpayer elects to receive the value of its ITC as a cash payment (discussed further under "*Direct Pay*"). If a taxpayer wants to make use of this direct pay option for the full value of the credit, then it must comply with the Domestic Content requirements. Otherwise, the value of the credit it will be able to receive as direct pay will be reduced for projects that start construction in 2024 with a phase down to 0% for projects that start construction after December 31, 2025.

New concepts and options associated with credit eligibility and receipt mechanics

Three new concepts applying to the credits appear throughout the Bill that are summarized here: (1) labor and wage requirements with respect to constructing and maintaining a project; (2) Domestic Content; and (3) direct pay.

Labor and wage

There are two general concepts derived from the labor code that can impact credit amount.

First, there is a "prevailing wage" requirement which requires that all laborers and mechanics employed by contractors and subcontractors must be paid wages at rates not less than the prevailing rates for construction, alteration, or repair of a similar character in the locality as determined by the Labor Secretary and Labor Department.

If applicable to a credit, failure to satisfy the prevailing wage requirement generally results in: (1) a requirement to make the laborers whole for reduced wages, plus interest; and (2) a penalty of USD5,000 per laborer that suffered diminished wages.

Second, there is an "apprenticeship" requirement which provides that the work done to construct, alter, or repair the facility enabling the credit must consist of a certain percentage of labor hours performed by a qualified apprentice. For this purpose, a qualified apprentice is an individual who is an employee of the contractor or subcontractor and who is participating in a registered apprenticeship program as defined under the National Apprenticeship Act of 1937 and the regulations thereunder.

In terms of relative hours requirements, for projects that begin construction prior to January 1, 2023, there must be at least 5% qualified apprentice labor hours; projects that start construction in 2023 require at least 10% qualified apprentice labor hours; and projects that start construction in 2024 or later require at least 15% qualified apprentice labor hours.

Labor hours are computed as the sum of the total number of hours devoted to the performance of construction, alteration, or repair work by employees of the contractor or subcontractor, but excludes hours worked by foremen, superintendents, owners, or persons employed in a bona fide executive, administrative, or professional capacity. The Bill references U.S. labor laws for evaluating whether a person is performing work that is excluded from the labor hours definition.

In terms of workforce headcount, if there are four or more individuals working on a project, at least one employee must be a qualified apprentice. This requirement is intended to satisfy the apprentice-to-journeyworker ratio set forth under federal labor laws.

Taxpayers are exempt from the qualified apprentice requirements if they demonstrate a lack of qualified apprentices in their geographic area, and fail to hire qualified apprentices after making a good faith effort to do so. For this purpose, a good faith effort means the taxpayer has requested qualified apprentices from a registered apprenticeship program, and such request has been denied, provided that such denial is not the result of a refusal by the contractors or subcontractors engaged in the performance of construction, alteration, or repair work on such applicable project to comply with the established standards and requirements of such apprenticeship program.

Domestic content

As noted above, the Bill also introduces a Domestic Content Bonus to Sections 45 and 48 of the Code as part of the Domestic Content policy; this provision appears to apply to projects that started construction prior to the Bill's enactment, which appears to be either an oversight or a potential uplift to existing projects. If the taxpayer satisfies certain Domestic Content requirements (ie the taxpayer can certify that any steel, iron, or "manufactured product" used in the construction of the facility was produced, mined, or manufactured in the U.S.), then the Domestic Content Bonus operates as follows:

- increase the PTC by 10%;
- for a project that does not have a maximum net output of less than 1 megawatt or does not satisfy either of the prevailing wage requirements or apprenticeship requirements, the ITC rate will be increased by 2%; and
- for a project that either: (i) has a maximum net output of less than 1 megawatt; or (ii) satisfies both of the prevailing wage requirements and apprenticeship requirements, then the ITC rate will be increased by 10%.

A "manufactured product" is deemed to have been manufactured in the United States if not less than 55% of the total cost of components of such product is attributable to components mined, produced or manufactured in the U.S.

If a qualified facility under Section 45 or an energy project under Section 48 does not satisfy the Domestic Content requirements, then the Bill applies a haircut to the amount of credit a taxpayer can elect to be treated as a cash payment (discussed further under "Direct Pay").

The Domestic Content rules are currently ambiguous in terms of how they operate under Sections 48E and 48D.

Tax credit	Domestic content bonus credit amount
PTC.	10%
ITC – For a project that either: (i) has a maximum net output of less than 1 megawatt; or (ii) satisfies both of the prevailing wage requirements and apprenticeship requirements.	10%
ITC – For a project that does not have a maximum net output of less than 1 megawatt or does not satisfy either of the prevailing wage requirements or apprenticeship requirements.	2%
Investment Credit for Electric Transmission Property – For a project that either: (i) has a maximum net output of less than 1 megawatt; or (ii) satisfies both of the prevailing wage requirements and apprenticeship requirements.	10%
Investment Credit for Electric Transmission Property – For a project that does not have a maximum net output of less than 1 megawatt or does not satisfy either of the prevailing wage requirements or apprenticeship requirements.	2%
Credit for New Qualified Plug-in Electric Drive Motor Vehicles.	USD4,500 for satisfying domestic assembly qualifications and USD500 for satisfying domestic content qualifications.

Direct pay

The Bill provides the option for taxpayers to make an irrevocable election to receive the value of the applicable tax credits as a cash payment. Under this election, similar rules related to basis reductions and recapture (if, and to the extent applicable to a particular credit) continue to apply, presumably suggesting automatic clawbacks in the event of a recapture. There is an additional reduction in direct pay associated with projects that have Domestic Content requirements, discussed below.

Mechanically, the Bill treats the amount of the direct payment as if the taxpayer made a payment equal to the direct payment to the Treasury at a time when it had zero income, thereby triggering a tax refund equal to the direct payment.

In a partnership context, the Treasury will make a payment directly to the partnership, and that payment will be treated as tax-exempt income. Accordingly, the partners to whom the payment is allocated will receive a basis increase in their partnership interest in order to take the cash distribution tax-free, and will not have a taxable share of income associated with the direct payment.

The Bill provides guardrails to prevent abuse. Specifically, any excessive payments (ie payments that exceed the amount of the available credit if no direct payment option were elected) are subject to a clawback with a 20% penalty. There is a reasonable cause exception to the clawback, though it will require a showing of reasonable cause to the satisfaction of the IRS, leaving the details to be sorted out through the regulatory process.

We expect transactions involving the direct pay option to look very similar to today's tax-equity transactions. That is because there will still be a need to ensure that there is a step-up in basis above cost (with either a sale to a different taxpayer or an inverted lease) and the parties will want to monetize depreciation. This is how the market worked during the cash grant program under the 2009 stimulus bill.

Under the Bill, the direct pay election is available for the following credits: PTC, ITC, 45Q Credit, credit for alternative fuel vehicle refueling property under Section 30C, and qualifying advanced energy project credit under 48C.

Reductions in credit and direct pay

In general, ITC and PTC projects that elect to use direct pay and that are eligible for the Domestic Content Bonus, are penalized for not meeting the Domestic Content requirements.

The value of the credit it will receive as direct pay will be reduced as follows:

- for projects that start construction in 2024, to 90% of the credit value;
- for projects that start construction in 2025, to 85% of the credit value; and
- for projects that start construction in 2026 or later, to 0% of the credit value.

ITC and PTC projects that do not elect to use direct pay merely do not receive the Domestic Content Bonus if they do not meet the Domestic Content requirements.

The Bill confusingly refers to this reduction as the "**Penalty for Direct Pay**," which we believe is better described as a reduction in the value of credits that a taxpayer may elect to receive as a cash payment for failure to comply with Domestic Content requirements.

Extend and enhance renewable and alternative energy incentives

The PTC

The PTC is expanded to include solar at the 100% rate, and increased for wind back to the 100% rate. Additionally, the PTC is extended for landfill gas (municipal solid waste), trash (municipal solid waste), qualified hydropower, marine and hydrokinetic renewable energy facilities, and geothermal.

More specifically, the Bill provides a 40% PTC for projects that started construction in 2020 or 2021 and are placed in service prior to January 1, 2022 and extends the full 100% PTC for wind and solar facilities that start construction before January 1, 2032, with a three-year phasedown thereafter. The provision appears to suggest that projects currently under construction for which taxpayers have safe harbored at a less-than 100% PTC rate can qualify for the 100% PTC by waiting to place in service on or after January 1, 2022; whether they must also satisfy the labor and wage requirements, or are eligible for the Domestic Content provisions, is unclear.

The labor and wage requirements apply, the direct pay option is available (subject to reductions described in "*Reductions in Credit and Direct Pay*"), and the Domestic Content Bonus is available to further increase the PTC. Notably, the Domestic Content Bonus does not phase down. There is some uncertainty in whether the PTC is available at the 100% level for projects placed in service after 2021, if construction started in 2017, 2018 or 2019.

The ITC

The Bill extends the full 30% ITC for existing technologies, and expands the scope of technologies eligible for the ITC.

More specifically, the Bill provides a 26% ITC for projects that started construction in 2020 or 2021 and are placed in service prior to January 1, 2022 and extends the full 30% ITC for projects that start construction before January 1, 2032, with a three-year phasedown thereafter. The provision appears to suggest that projects currently under construction for which taxpayers have safe harbored at a 26% ITC can qualify for the 30% ITC by waiting to place in service on or after January 1, 2022; whether the Bill will be modified to require satisfaction of the labor and wage requirements is unclear. The Bill extends the ITC to the following projects:

- Solar
- Geothermal
- Fiber-optic solar equipment
- Fuel cell property
- Microturbine property
- Combined heat and power property
- Small wind energy property
- Biogas property
- Waste energy recovery property
- Offshore wind property

New technologies eligible for the ITC are:

- Energy storage technology
- Linear generators
- Microgrid controllers
- Dynamic glass
- Biogas property

The ITC is subject to the labor and wage provisions, the direct pay option is available (subject to reductions described in "Reductions in Credit and Direct Pay"), and the Domestic Content Bonus is available to further increase the ITC.

There is a phasedown to 0% PTC over 3 years starting in 2032. The ITC is 10% for property construction of which begins before January 1, 2034 and is placed in service after December 31, 2035. It also expands the ITC to include stand-alone energy storage facilities with a capacity of at least 5 kWh.

Carbon capture 45Q Credit

The Bill proposes revising the 45Q Credit by:

- Adding a direct pay option.
- Conditioning full credit on satisfying labor and wage requirements.
- Reducing the capture thresholds for qualifying activities, while adding a minimum relative capture requirement.
- Retaining a USD50/mt credit for carbon that is captured and permanently sequestered and a USD35/mt for carbon that is used as a tertiary injectant or for enhanced oil recovery ("**EOR**").
- Increasing the credit to USD130/mt for utilization activities and to USD180/mt for direct air capture ("**DAC**") facilities.
- Extending the start of construction deadline from January 1, 2026 to January 1, 2032.

Start of construction

The Bill proposes to extend the start of construction deadline by a full six years, enabling projects to start construction by January 1, 2032 to qualify for the 45Q credit.

There is no impact to the 12-year credit period and, consistent with prior legislation, there is no placed in service requirement as a condition to qualifying for the credit.

Threshold Reduction and Relative Capture Requirements; Certain Credit Increases

The Bill proposes to modify the total amount of carbon that facilities are required to capture, while also imposing a minimum relative capture requirement. Specifically:

- DAC facilities must capture at least 1,000 metric tons of carbon.
- Electricity Generating Facilities ("**EGF**") must capture at least 18,750 metric tons of carbon *and* at least 75% of their total annual carbon emissions.
- Any facility other than a DAC or EGF must capture at least 12,500 metric tons of carbon *and* at least 50% of their total annual carbon emissions.

In addition to the capture modifications, DAC facilities are eligible for a higher credit. Specifically, the Bill increases the credit for DAC facilities to USD180/ton if the carbon is securely stored in geological storage, and USD130/ton if the carbon is used in enhanced oil recovery or otherwise utilized: (1) in connection with certain photosynthesis or algae production; (2) as part of a chemical process to convert the carbon into a chemical compound into which the carbon is sequestered; or (3) in connection with a process that has a commercial market (other than for EOR or use as a tertiary injectant).

The 45Q Credit is subject to the labor and wage provisions, and the direct pay option is available. There is no Domestic Content Bonus available.

Additional credits

The Bill also includes proposals relating to a number of other tax credits including the following:

- Increase in energy credit for solar facilities placed in service in connection with low-income communities
- Investment credit for electric transmission property
- Zero-emissions facility credit
- Green energy publicly traded partnerships
- Zero-emission nuclear power production credit
- Sustainable aviation fuel credit
- Credit for production of clean hydrogen
- Election to treat clean hydrogen production facilities as energy property
- New qualified plug-in electric drive motor vehicles
- Previously-owned qualified plug-in electric drive motor vehicles
- Credit for qualified commercial electric vehicles
- Reinstatement and expansion of employer-provided fringe benefits for bicycle commuting
- Credit for certain new electric bicycles
- Labor costs of installing mechanical insulation property
- Qualified environmental justice program credit
- Reinstatement of superfund

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