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Orrick: IRS Issues Direct Pay and Transferability Proposed Regulations

On June 14, 2023, the IRS and Treasury issued proposed regulations (the “Proposed Regulations”) under two novel provisions of the Inflation Reduction Act of 2022 (the “IRA”) designed to promote capital investment in renewable energy: (1) “direct pay,” allowing certain tax-exempt, taxable and government entities to elect to receive cash payments from the federal government in lieu of energy tax credits and (2) “transferability,” allowing the transfer of energy tax credits to unrelated parties in exchange for cash payments.[1] Important details in the Proposed Regulations are summarized below. The Proposed Regulations are of interest to anyone thinking about developing or financing a renewable project or anyone interested in acquiring tax credits from another renewable energy project. The IRS and Treasury also issued temporary regulations (“Temporary Regulations”) with an immediate effective date.

The Direct Pay Rules

Overview

The direct pay rules permit certain entities to receive a direct payment of certain tax credits. Eligible entities include tax-exempt organizations, states, and political subdivisions such as local governments, Indian tribal governments, Alaska Native Corporations, the Tennessee Valley Authority, rural electric co-operatives, U.S. territories and their political subdivisions. The Proposed Regulations clarify that agencies and instrumentalities are also eligible for direct pay.[2] These entities will find direct pay to be a particularly attractive financing mechanism.

The following twelve credits are eligible for direct pay:

1. The credit for alternative fuel vehicle refueling / recharging property (Section 30C);
2. The renewable electricity production credit (Section 45);
3. The carbon oxide sequestration credit (Section 45Q);
4. The zero-emission nuclear power production credit (Section 45U);
5. The clean hydrogen production credit (Section 45V);
6. The commercial clean vehicle credit (Section 45W);
7. The advanced manufacturing production credit (Section 45X);
8. The clean electricity production credit (Section 45Y);
9. The clean fuel production credit (Section 45Z);
10. The energy credit (Section 48);
11. The qualifying advanced energy project credit (Section 48C); and
12. The clean electricity investment credit (Section 48E).

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