Unlocking Clean Energy Projects Using Tax Chaining: A Primer

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INTRODUCTION TO CHAINING

US policy to incentivize the development and deployment of clean energy and technology lies in the tax code. Thanks to the Inflation Reduction Act (IRA) of 2022, the Department of the Treasury has even more ways to drive climate progress through new mechanisms like ***transferability*** (the ability to transfer generous tax credits to other entities) and ***elective*** or ***direct* pay** (which enables nontaxable entities to receive direct payments in lieu of tax credits), thereby expanding opportunities for more parties to participate in—and benefit from—clean energy and technology development. This primer focuses on marrying transferability and direct pay to add one more significant arrow to the financing quiver known as ***chaining***.

Chaining would make it possible to transfer certain tax credits to direct pay–eligible entities to access capital for project development. Importantly, chaining would open up financing not only for large projects, but also smaller, more locally driven and civically minded projects that can be very difficult to finance, even with the new transferability and direct pay rules in place. By extending the reach of financing for clean energy and technology projects, chaining increases the ability to achieve climate targets, build the United States' industrial base, create jobs, improve communities, and reach environmental justice outcomes.

THE BASIC COMPONENTS OF CHAINING

- **Transferability** allows for 11 clean energy tax credits to be sold to a third-party purchaser, which uses the transferred tax credit to reduce its own tax liability.
- **Direct pay** (also known as *elective* pay) allows tax-exempt entities (e.g., school districts, municipalities, nonprofits) to receive a direct cash payment from the IRS in lieu of 12 tax credits for clean energy-related activities.
- **Chaining** links transferability and direct pay by allowing tax credits to be sold to tax-exempt entities, which convert the credit into a cash payment.

Chaining multiplies the potential to meet US national and state climate goals in a way that direct pay and transferability alone cannot. It does so by lowering capital costs, thereby unleashing the types, sizes, and numbers of clean energy projects that can be deployed.

The benefits of chaining extend far beyond providing greater and swifter access to clean energy and technology project financing, including:

- Helping to unleash the IRA's full suite of benefits and even broader implementation by greatly expanding the pool of capital for project developers, including capital from tax-exempt entities—not just for-profit entities—while also ideally lowering the transaction cost for all parties
- Directly addressing growing concerns that tax credit market counterparties cannot provide sufficient demand to keep up with the tax credits that are expected to be generated, with particular benefit for riskier or smaller projects that may not be able to access financing through traditional equity markets or transferability alone
- Providing additional benefits like expanding the types of projects that can be deployed, such as smaller, community-level projects; increasing community involvement and self-determination in the development of locally beneficial projects; securing environmental justice outcomes; making it possible for low-carbon energy to keep pace with anticipated load growth; and accelerating climate-focused industrialization and onshoring of clean energy and technology manufacturing

Treasury is now accepting comments on chaining through **December 1, 2024**. The policy brief Unlocking Clean Energy Projects Using Tax Chaining: A Primer helps the public understand chaining, explain potential use cases, and highlight opportunities for chaining to fill market gaps that exist today. In the months ahead, as public awareness regarding chaining increases and support for chaining grows, interested parties should engage Treasury and submit comments to allow for chaining, which the authors argue is within both the scope and spirit of the IRA.

Like all tax mechanisms, chaining is not immune to abuse. In addition to discussing the specifics of chaining, the authors address ways to curb potential abuses in the July 2024 chaining report.

The authors invite emails for additional information or to submit questions.

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