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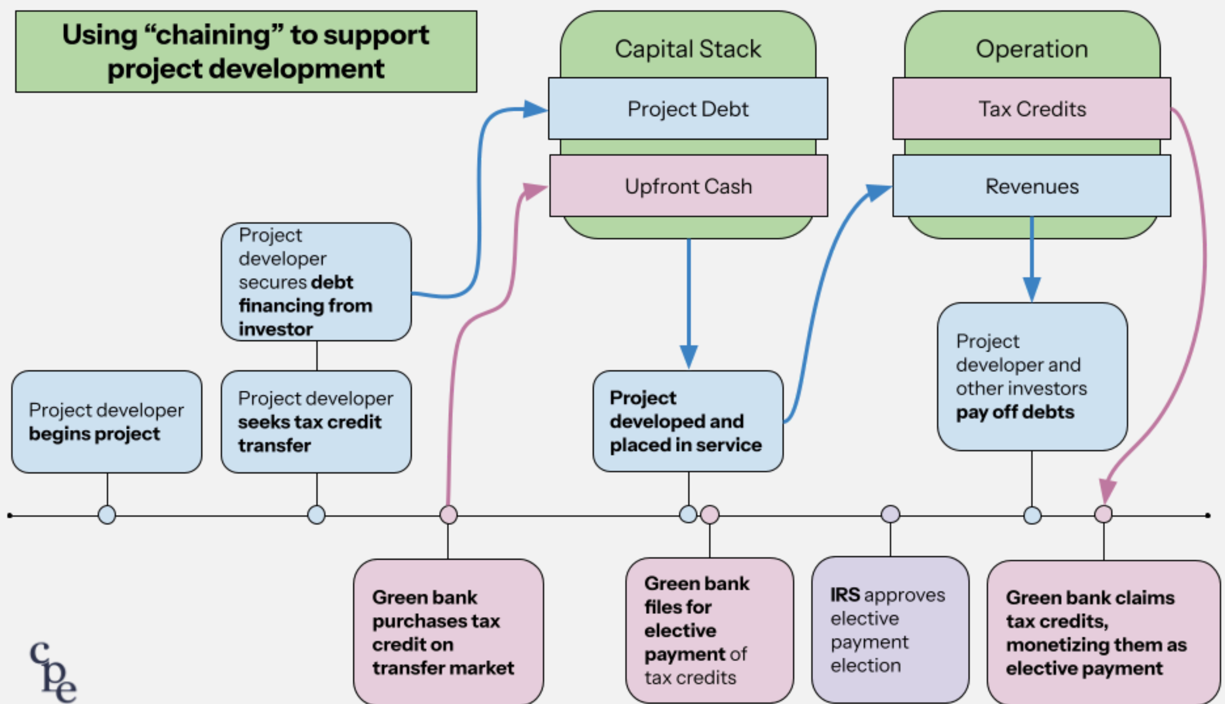
How Tax Credit "Chaining" Expands the Reach of the IRA Through Greater Public Participation in Project Development

The Department of Treasury is soliciting comments on final rules regarding tax credit chaining. Tax credit chaining allows public and nonprofit entities to purchase tax credits and monetize them through the elective pay mechanism. A decision by the Treasury that enables chaining between elective pay-eligible entities would greatly expand the impact of elective pay by making it easier for small municipalities and nonprofits to work with larger, better-resourced partners on the development of clean energy projects. The Treasury can also clarify its guidance to address concerns about potential abuse of the process by private sector entities.

What is chaining, and how does it work?

The IRA expanded the availability of tax equity finance through two provisions. First, it allowed for tax credits to be transferred to third-party investors, broadening the market and reducing the cost of finance for renewable energy project development. Second, it created an elective pay option for tax-exempt government and nonprofit entities, allowing them to monetize tax credits by applying for a direct payment from the IRS. Elective payment of tax credits allows the public sector to participate in the development of renewable energy. Chaining would allow an entity that is eligible for elective pay to purchase a tax credit via the transferability provisions of IRA and then monetize the tax credit by applying for elective pay.



Why is chaining important?

Private tax-liable developers currently sell their tax credits at a discount to tax equity investors or to buyers on the transferability market. But these discounts are larger for smaller or riskier projects. Chaining, which allows elective pay-eligible entities to purchase and monetize those credits, adds new potential buyers to the market, thereby raising demand for all tax credits (and lowering the discount developers pay to lenders relative to the tax credit's face value). For riskier or smaller private projects, chaining could mean the difference between an unviable project and a successful project, insofar as chaining allows faster monetization at a lower cost to developers.

Chaining also improves the viability of using elective pay, especially for smaller eligible entities. While local governments and nonprofits are often closest to the ground and have the most creative solutions to their community's challenges, they face two major hurdles in competing with private sector developers. First, they often lack capacity in tax law and project development, preventing them from participating in the administratively complex process for applying for elective pay. Second, they lack the "upfront" capital that private developers have to begin development on a project and qualify for elective pay after the project begins operation.

Chaining resolves both of these challenges by empowering municipalities and non-profits to do what private entities can already do: sell the rights to their tax credit on a transfer market to another public entity, such as a state green bank, in return for upfront cash they can use for pre-development and construction. Chaining also allows the state green bank to handle the administrative burden of applying for elective pay in the first place.

Chaining thus promotes both public developer-public investor partnerships and private investor-public developer partnerships.

How should chaining be implemented?

The Department of Treasury has expressed concerns that chaining would allow private companies to sell their credits to captive non-profit, elective pay-eligible entities designed expressly to monetize tax credits for partner private-sector entities. Such maneuvers would undermine the intention of the IRA to reserve the use of elective pay to nonprofits and governments (with the exception of those specific credits for which the private sector can claim elective pay). These concerns can be mitigated by limiting chaining to established "green banks" and other public financing institutions. US energy policy post-IRA already relies on these entities to tie together state and federal policy through the Greenhouse Gas Reduction Fund, the Loan Programs Office's State Energy Financing Institution (SEFI) carveout, and other mechanisms, such as state infrastructure or bond banks. These organizations have sophisticated due diligence processes, high levels of administrative capacity, and the ability to finance projects. They have also already been vetted by the EPA or DOE for eligibility for IRA lending programs.

What are the disadvantages of the status quo?

Transferability markets continue to disadvantage small projects. While expectations of higher demand this year should lower the discount that project developers face when they sell their tax credits, transferability analytics from Basis and Crux—two leading tax credit brokerages—found that, as of 2023 Q4, tax credits for projects under $20 million still traded at a discount of 10 percent or greater. By allowing new, mission-driven buyers to enter the transferability market, chaining can improve liquidity of and reduce the discount on the tax credits of these smaller projects' credits, including practically all community solar and resilience investments.

Finally, tax credit markets are procyclical, meaning that negative shocks to economic conditions decrease investor participation in tax equity and transferability transactions. When lower growth and lower incomes reduce investors' tax liabilities, those investors will simply have less capacity to purchase the rights to tax credits, resulting in less investment when it is most needed. This worry is not theoretical—it has happened before.

Allowing public entities to engage in chaining transactions helps cushion against economic shocks and embeds countercyclical market interventions into tax credit markets. Public institutions are not limited by their tax liabilities, but by their budgets and risk tolerance. Thus, chaining allows dedicated institutions to act quickly to sustain strategic projects in downturns, saving jobs and making sure that complex, multi-year decarbonization plans are not derailed.

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