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RSM

Hospital Finance and the Inflation Reduction Act of 2022

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IRA - Introduction

- The **Inflation Reduction Act** (the "IRA") provides billions of dollars in funding through tax incentives that health systems can use to help **lower their carbon footprint, reduce future operating costs** and finance clean energy infrastructure projects, such as:
  - On-site micro-grids
  - Roof top solar energy
  - Covered parking with solar energy
  - Installation of EV chargers
  - Electrification of any commercial vehicles
  - Energy efficient building improvements
  - Solar project investing

IRA – Clean Energy Roadmap

- These incentives are even available to for profit **and** nonprofit organizations and local governments through direct payments for qualified investments.
- However, there are time limits on when these incentives are available and there are important considerations related to eligibility and structuring the investment.
- Given the tight timeline, many organizations are looking to **modify existing projects** to include components that would make such project eligible for incentives under the IRA.

IRA – Tax Credits and Deductions

Energy Generation

Investment Tax Credit - *Section 48*

→ *NEW* Clean Electricity Investment Credit – *Section 48E*

Production Tax Credit – *Section 45*

→ *NEW* Clean Electricity Production Credit – *Section 45Y*

Clean Vehicles

NEW Qualified Commercial Vehicles - *Section 45W*

Alternative Fuel Vehicle Refueling Property - *Section 30C*

Clean Energy Incentives

Energy Efficient Commercial Buildings – *Section 179D*

IRA Overview – Two Tier Tax Credit Structure

- The focus of this discussion is on the two types of Tax Credits:
  - The **<u>Production Tax Credit</u>** under section 45 - PTCs
  - The **<u>Investment Tax Credit</u>** under section 48 - ICTs
- Each credit is now structured to have a base rate.
- Each Project may get an ***increased rate equal to 5 times the base rate*** if the prevailing wage and apprenticeship requirements are met (or the project is exempt from such requirements).

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Production Tax Credit (IRC 45)

- A credit for electricity produced from qualified resources (e.g., wind, geothermal) and sold to an unrelated person during the taxable year.
- Credit period of ten years beginning on the date the facility was originally placed in service.
- The base rate is set at 0.3 cents (or 1.5 cents) per kilowatt hour (rate increases for inflation).

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Investment Tax Credit (IRC 48)

- A credit of 30% (or 6%) of the basis of qualified property placed in service during the tax year.
- Required basis reduction: 50% of the credit.
- Recapture period: 5 years after placed in service (PIS) date.
- Qualifying Property: fuel cell, solar, wind, waste energy recovery, energy storage, biogas, microgrid controllers, combined heat and power, equipment using groundwater as a het source, microturbine property.

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Qualified Commercial Clean Vehicles (IRC 45W)

- New credit for clean vehicles that are subject to depreciation.
- Vehicle must have a battery capacity of 7 kWh if under 14,000 lbs. or 14 kWh if above 14,000 lbs.
- Credit is the lesser of:
  - 30% of the basis (15% if the vehicle is a hybrid)
  - “Incremental cost”
    - Maximum credit of $7,500 if under 14,000 lbs.
    - Maximum credit of $40,000 if 14,000 lbs. or greater.
- Basis reduction of the credit amount and subject to recapture
- VIN of each vehicle must be included on the tax return in the year the credit is claimed

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Alternative Fuel Vehicle Refueling Property Credit (IRC 30C)

- "EV Charger Credit"
- 30% of basis if Prevailing Wage and Apprenticeship Requirements are met
- Up to $100,000 per single item of property
- Property must be located in a low-income or rural census tract
- Basis reduction of credit amount and subject to recapture
- Industry-neutral credit

Energy Efficient Commercial Building Deduction (IRC 179D)

- *Deduction* based on the square footage of energy efficient buildings
  - Interior lighting systems
  - Heating, ventilating and air conditioning (HVAC) and hot water systems
  - Building envelope (insulation, exterior doors & windows, roof materials)
- New constructions or retrofits.
- Building is compared to a reference building under ASHRAE 90.1 and have a reduction of at least 25% of the total annual energy and power costs.
  - Certification must be performed by an independent credentialed engineer
- The new allowed deduction ranges from $0.50 to $1.00 per square foot based on energy savings in the range of 25% to 50%+ ($.02 for every percentage point up to $1.00 maximum).
  - $2.50 to $5.00 if prevailing wage and apprenticeship requirements are met during project installation
- Deductions for government and not-for-profit organizations can be allocated to the designer of the system.

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IRS Overview – Prevailing Wage and Apprenticeship Requirements

- The **5 times multiplier** in the "base rate" of PTCs and ITCs if either of the below three (3) conditions apply:
  - The project has a **maximum net output of less than 1 megawatt** of electrical (as measured in alternating current) or thermal energy
  - The **project begins construction before January 29, 2023**
  - The project satisfies the **PWA** requirements
- PWA requirements also apply to EV Charging Credit.

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Prevailing Wage Requirements

- Laborers and mechanics who work on the construction of a facility **<u>must be paid prevailing rates</u>**, including laborers and mechanics employed by the taxpayer or any contractor or subcontractor.

- The prevailing wages requirement are based on the **<u>Davis-Bacon Act</u>**, which imposes wage requirements for construction workers for federally funded projects. Under the Davis-Bacon Act, there are general wage determinations, which apply generally to certain areas and job types, and project wage determinations. If there is not a prevailing wage, the taxpayer may request a wage determination.

- **<u>Correction and Penalty</u>** – If a laborer or mechanic is not paid prevailing wages, the taxpayer can satisfy the prevailing wage requirement by paying the difference plus interest to the laborer and penalties to the Treasury.

- The Treasury may **<u>recapture</u>** financing if a project does not meet the prevailing wage requirements.

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Apprenticeship Requirements

- A certain percentage of total labor hours for the construction of a facility must be performed by qualified apprentices (i.e., apprentices participating in a qualified apprenticeship program).
- Applicable Percentages:
  - Construction before 2023: 10%
  - Construction begins in 2023: 12.5%
  - Construction begins in 2024 or later: 15%
- Each taxpayer, contractor, or subcontractor who employs more than four individuals to perform such work must employ **<u>at least one qualified apprentice</u>** to perform such work. Thus, the effective percentage might be higher than the above percentages.
- **<u>Correction and Penalty</u>** – If the above requirements are not met, the taxpayer can satisfy the apprenticeship requirement by paying to the Treasury $50 for every labor hour in which the above requirements were not satisfied (x10 multiplier if intentional disregard for requirement).
- **<u>"Good Faith"</u>** Efforts – Taxpayer must make reasonable efforts to comply.

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Tax Credit Adders

- **<u>Domestic Content</u>** (+10%)
  - Requires manufactured processes and products to be of US origin.
- **<u>Energy Community</u>** (+10%)
  - Based on location and includes areas where significant employment has historically been related to the extraction, processing, transport, or storage of **<u>coal, oil, or natural gas.</u>**
- **<u>Environmental Justice Allocation</u>** (up to 20%)
  - Only available to solar and wind project that produce less that 5 Megawatts claiming an ITC. The IRS will award allocation as follows:
    - Located in a low-income community (10%)
    - Located on Indian Land (10%)
    - Part of a "qualified low-income residential building project" (20%)
    - Part of a "qualified low-income economic benefit project" (20%)

Solar Example

- A solar energy project cost $10 Million US dollars.
  - The ITC is $3Million
  - Tax Basis is $8.5 Million ($10 Million less half the credit)
  - Bonus Depreciation allows taxpayer to claim $1,785,000 ($8.5 Million times corporate tax rate of 21%)
  - Total federal tax benefit in the first year of the solar energy project is $4,785,000, which equals **<u>47.8%</u>** of the total project cost.

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New & Existing Opportunities for Monetization

Elective Payment of Applicable Credits	Direct Pay	Effectively refundable credits
Transfer of Certain Credits	Selling	New market to sell credits for cash
Tax equity	"Partnership flip structure"	Still permissible under IRA	May not work for all credits

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Direct Pay (IRC Section 6417)

- If election is made, treated as making a payment against the tax imposed by subtitle A equal to the amount of such credit.
  - In essence, receive a cash refund, assuming no other tax liability.
  - Election is made on a per facility/project/equipment basis.
  - Election is revocable **once.**
- Eligible entities: entities exempt from tax imposed by subtitle A, state or local government, the TVA, an Indian tribal government, any Alaska Native Corporation, or certain rural cooperatives.
  - Partnerships with eligible entity partners are NOT eligible entities
  - No chaining of transferability and direct pay as a work-around.

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Direct Pay

- Pre-filing registration with IRS is required to claim credit on tax return
  - New registration each year for PTCs
  - Separate registration per energy property/facility

- Tax-Exempt entities must file tax return to claim credit
  - Must claim on an original return

Transferability (IRC Section 6418)

- Election (made on a yearly basis) for eligible taxpayer to transfer all (or any portion) of an eligible credit to an unrelated taxpayer.
  - Consideration must be paid in cash.
  - Consideration is not includible in gross income of the eligible taxpayer, and with respect to the transferee taxpayer, is not deductible.
  - Consideration for a credit can be paid any time between the first day of the transferor's taxable year in which the credit is generated and the due date for the tax return (including extensions) that includes the transfer statement election.
- Taxpayers who are not eligible for direct pay are eligible for transferability.
- A credit can only be transferred once. The use of a broker to facilitate a credit transfer would not be considered a second transfer.
- Registration is a prerequisite for credit transferability.
  - Yearly registration for PTCs.

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Available Finance Structures for Hospital and Hospital Systems

- Debt Financing -
- Tax Equity Financing – Hospital makes an investment in the Project or company undergoing the project and receives tax benefits in return
- M&A
- Transferability - both the investor and seller would like the right to
- cause the partnership to sell their share of tax credits

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What should companies be thinking about?

- Do I want to reduce costs?
- Do I want to become less reliant on the grid?
- What are my strategic long term decarbonization goals?
- Do I have any systems that need to be replaced (windows, HVAC)?
- Am I replacing any commercial vehicles?
- Am I installing EV chargers?

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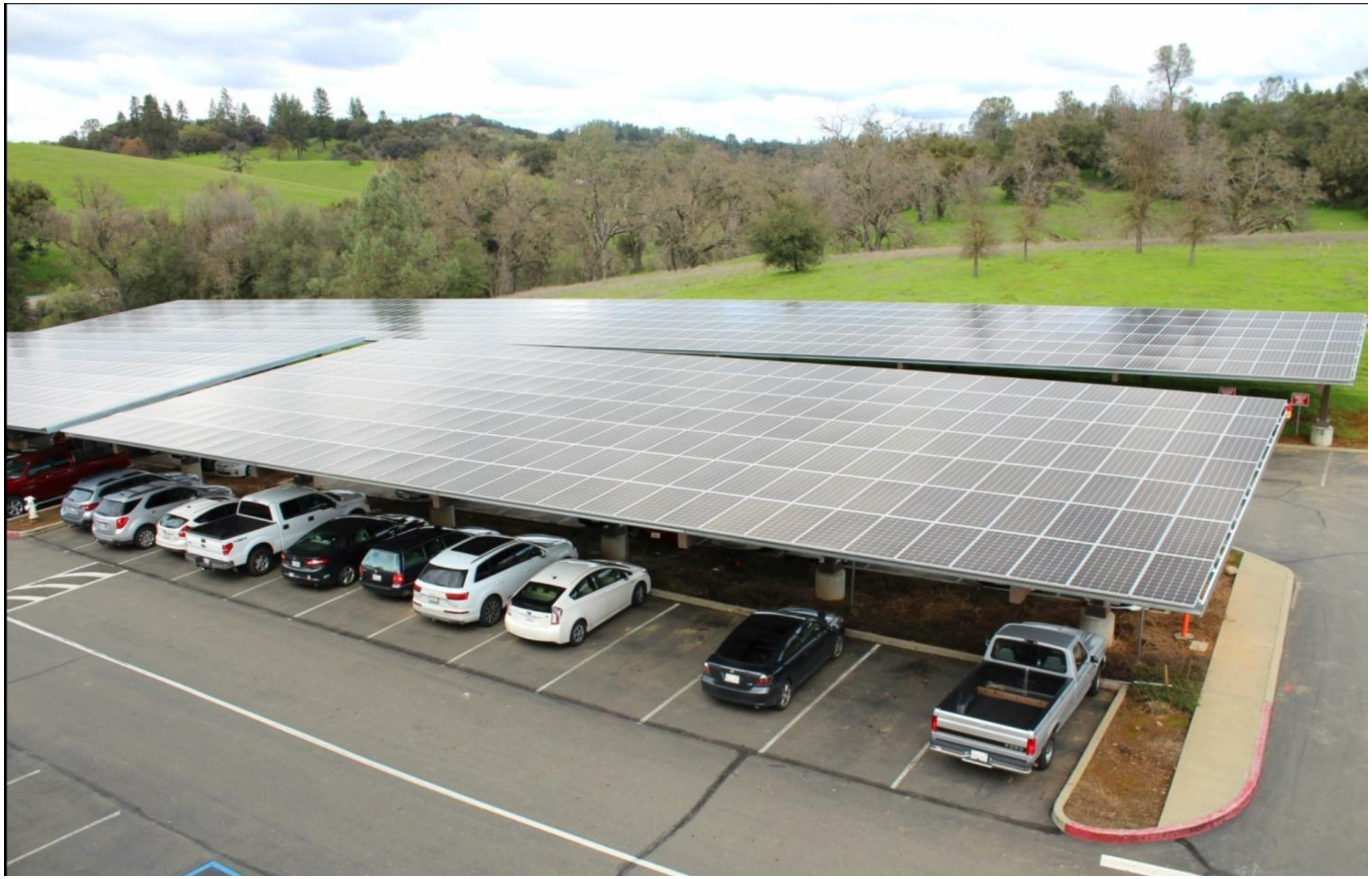
Solar Canopy



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EV Charger

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Questions