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Energy and Climate Tax Credits for the Health Care Sector

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The Inflation Reduction Act (IRA) of 2022[1] represents a historic investment in confronting climate change and building a clean economy.[2] The IRA includes many incentives in the form of tax credits and deductions to incentivize both for-profit and tax-exempt organizations to adopt renewable energy and more efficient technologies. These incentives can be particularly helpful to 501(c)(3) health systems who purchase and consume vast amounts of energy from the grid. Under the IRA, health systems and health care organizations can receive direct cash payments for installing solar energy facilities that provide numerus long-term benefits, including reduced energy costs and more direct control over the systems' energy needs.

Monetization of Credits

Tax-exempt organizations would ordinarily have little need for income tax credits. Thus, to make the concept of clean energy credits more enticing, the IRA created new opportunities for tax credit monetization. The IRA includes a mechanism commonly referred to as "Direct Pay." Direct Pay, codified as IRC Section 6417, provides that a 501(c) organization—such as a charitable heath system—may receive a direct cash payment from the IRS equal to the value of their "applicable credits" (after reduction for any otherwise unrelated business income tax due from the organization). Most of the key IRA credits applicable to a 501(c)(3) health system and health care organizations are eligible for Direct Pay, including the investment tax credit, discussed in detail below.

With respect to for-profit entities, the IRA also includes a new transferability feature, which allows for-profit project owners to sell their IRA tax credits for cash to other taxpayers.[3] This new mechanism can eliminate the added expense of having to form tax partnerships and also makes direct ownership of projects more enticing to for-profit entities.

Clean Renewable Electricity

Arguably one of the most important provisions in the IRA involves the expansion, in both scope and amount, of the investment tax credit (ITC) found under IRC Section 48.[4] The ITC provides a credit based on the upfront costs of constructing specific types of clean energy generating assets. There are numerous types of these assets that can be beneficial to health systems and health care organizations who are looking to purchase less power from the grid and have the desire to generate clean energy from their own assets, i.e., solar arrays, energy storage systems, microgrid controllers, qualified small wind turbines, geothermal property, combined heat and power property, and waste energy recovery property.

The base rate of the ITC begins at 6% of the cost of the qualified property. The value of the credit is increased to 30% if the prevailing wage and apprenticeship requirements are met. This value has the ability to increase to much higher amounts if certain other bonus incentives are met. There is an additional credit of up to 10% of the cost for meeting the domestic content requirements. Likewise, there is the same level of additional credit if the property is located in an area that has been designated an "energy community." An energy community is an area designated as such by the government due to its status as a brownfield or its historic dependence on fossil fuels to provide jobs and tax revenues.

Energy Efficient Commercial Buildings

Health systems and other health care organizations looking to construct new facilities should consider IRC Section 179D, which was drastically expanded by the IRA. This provision incentivizes the construction or retrofitting of energy efficient commercial buildings. Starting January 1, 2023, the maximum deduction amount for the installation of energy efficient commercial building property increased from $1.88 per square foot to $5 per square foot (adjusted for inflation). Energy efficient commercial building property is property that, among other requirements, is installed as part of either (i) the interior lighting system of the building, (ii) the heating, cooling, ventilation, or hot water systems of the building, or (iii) the building envelope.

The level of credit that a project qualifies for depends on the level of energy efficiency the building achieves and whether the prevailing wage and apprenticeship requirements are met. The IRA eliminated a lifetime cap on this incentive, and deduction limits will now reset every three to four years, depending on the tax-status of the owner of the building. The IRA also expanded the IRC 179D deduction allocation eligibility to designers of commercial buildings owned by tax-exempt entities. As a result, tax-exempt organizations can allocate the IRC Section 179D deduction as part of contract negotiations with their design professional and, therefore, obtain a reduction to the costs of construction.

The IRA also changed the reference building standard used to determine the building's energy efficiency. Buildings placed in service on or after January 1, 2023 should use the American Society of Heating, Refrigerating and Air-Conditioning Engineers standards affirmed by the secretary at least four years before construction completion, a change from the current standard of two years before the start of construction. For more information on the updated reference building standards for 2023, see IRS Announcement 2023-1.[5]

Vehicles and Vehicle Refueling
Qualified Commercial Clean Vehicle Credit under IRC Section 45W

Health systems and other health care organizations that operate a fleet of ambulances or security vehicles may benefit from the Qualified Commercial Clean Vehicle Credit under IRC Section 45W, which incentivizes the purchase of hybrid-powered and completely clean energy-powered vehicles. The credit amount is the lesser of (i) 15% of the vehicle's cost to the buyer or 30% for vehicles without internal combustion engines, i.e., not powered by gas or diesel, or (ii) the amount the purchase price exceeds the price of a comparable internal combustion engine vehicle, i.e., the incremental cost of the vehicle. For taxpayers to qualify for the credit, the vehicle must be made by one of the companies listed on the IRS index of qualified manufacturers.[6] Taxpayers cannot transfer the Section 45W tax credit to the registered dealer. However, tax-exempt organizations can use the direct pay option to receive the value of this tax credit in cash.

Alternative Fuel Vehicle Refueling Property Credit under IRC Section 30C

For health systems and other health care organizations that operate in low-income communities and non-urban areas, the IRA provides a tax credit for alternative fuel vehicle refueling and charging property (e.g., electricity, ethanol, natural gas, hydrogen, and biodiesel), starting January 1, 2023 through December 31, 2032. For businesses and tax-exempt organizations, the base credit is 6% of the cost of the refueling station, limited to a maximum of $100,000 credit per refueling station. However, organizations can claim a 30% credit for projects that meet the prevailing wage and apprenticeship requirements. For property used in a trade or business, taxpayers can transfer this tax credit under IRC Section 6418 and tax-exempt organizations can use the Direct Pay option under IRC Section 6417.

Conclusion

A growing number of health care organizations have signed onto Health and Human Services' Climate Pledge. The Climate Pledge is a voluntary commitment to reduce greenhouse gas emissions by 50% by 2030 and achieve net zero emissions by 2050. Fortunately, the IRA offers health care organizations—including tax-exempt health systems—incentives to adopt the technology that will make achieving this long-term goal possible. Renewable sources of energy may also offer health care organizations other benefits such as reduced energy costs. We strongly encourage health care organizations to speak with their tax advisor before undertaking any substantial capital improvements or capital expenditures to see if the IRA offers any relevant funding.

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[1] P.L. 117-169, August 16, 2022.
[2] On June 30, 2022, President Biden announced the Health Sector Climate Pledge. As a result, the U.S. Department of Health and Human Services in partnership with the White House, is mobilizing the Health Sector to reduce greenhouse gas emissions. https://www.whitehouse.gov/briefing-room/statements-releases/2022/06/30/fact-sheet-health-sector-leaders-join-biden-administrations-pledge-to-reduce-greenhouse-gas-emissions-50-by-2030/.
[3] IRC Section 6418.
[4] Beginning January 1, 2025, this credit expands in scope to become the IRC Section 48E "Clean Electricity Investment Credit."
[5] https://www.irs.gov/pub/irs-drop/a-23-01.pdf.
[6] https://www.irs.gov/credits-deductions/manufacturers-for-qualified-commercial-clean-vehicle-credit.

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