

## Direct Pay: Supporting Decarbonization of State and Municipal Governments

### What is Direct Pay?

Through the Inflation Reduction Act of 2022, clean energy tax credits for technologies such as solar panels, geothermal heat pumps and battery storage are now accessible to state and local governments and other tax-exempt entities. This is possible through a mechanism known as direct pay (also known as elective pay), where municipal governments and other tax-exempt entities can get reimbursed up to 50 percent for the cost of clean energy projects, by the U.S. Internal Revenue Service, once projects are placed in service. Recent changes under the One Big Beautiful Bill Act, passed in July 2025, have modified the availability and terms of these credits, which is reflected in the information below.

### What Qualifies for Direct Pay?

There are a total of 12 clean energy tax credits where direct pay is applicable. However, the clean energy tax credit most relevant to decarbonizing municipal buildings is the Investment Tax Credit (ITC 48E/48) because of the value of the credit (up to 50 percent of a project reimbursed) but also because tax credits for EV charging stations and for EV fleets are negatively impacted by the shorter timelines due to OBBBA (see table below).

Municipal-relevant tax credit	Updated availability (from OBBBA changes)
Solar panels (48E)	Terminates Dec. 31, 2027 (unless construction begins by July 4, 2026)
Battery storage (48E)	Available through Dec. 31, 2035
Thermal energy storage (48E)	Available through Dec. 31, 2035
Geothermal heat pump (48)	Available through Dec. 31, 2034
EV charging stations (30C)	Terminates June 30, 2026
EV fleet (45W)	Terminated as of Sept. 30, 2025

**HVAC sidenote:** Geothermal heat pump systems (also referred to as ground source heat pumps) can serve as replacements of traditional HVAC systems and can cut energy bills by up to 65 percent.<sup>1</sup> In addition, heat pumps can provide improved indoor air quality and provide better temperature control.

### The Payoffs

- Direct pay reimbursements can be reinvested back into the budget to help cover expenses such as operational, maintenance, capital and staffing costs.
- Additional money comes from annual energy savings from installing clean energy technologies.

- HVAC upgrades and EV fleets lead to improvements to indoor and outdoor air quality, supporting the health of staff and the broader community.
- Municipal buildings powered by renewable energy and battery storage can create climate resilient hubs during power outages.
- Upgrading municipal buildings will create good jobs and job training opportunities in the local community.
- Upgrading municipal buildings will contribute to emissions reductions to help meet local and state climate goals.

## Recommended Next Steps

1. If you already have a planned solar project, commencing construction before July 4, 2026, will help ensure qualifying for the 48E tax credit for solar before it expires.
2. Build your support network: Coordinate with your state energy office, state education agency, state department of commerce, local sustainability office and/or local utility to learn about additional available funds, see local examples and get technical assistance.
3. Identify upfront financing: This may include municipal bonds, state grant programs, utility rebates, state green banks, credit unions, community development finance institutions and energy service companies.

## Additional Resources

- BlueGreen Alliance: [Making Clean Energy Tax Credits Deliver for the Public](#)
- Lawyers for Good Government: [Elective Pay & IRA Tax Incentives Resources Page](#)
- Local Infrastructure Hub: [Direct Pay Full Report](#)
- S2 Strategies: [State Support Center](#)

## For questions or to learn more about direct pay, contact:

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## Case study

The city of Madison, Wis., expects over \$13 million in direct pay reimbursements to help finance sustainability improvements to municipal and community facilities. This includes solar installations at the Community Development Authority's Truax Campus and geothermal systems at multiple facilities, including a men's homeless shelter, the Imagination Center at Reindahl Park, the Streets Far West Facility, and the Police Property and Evidence Facility and South District Station.<sup>ii</sup>

i. [www.energy.gov/eere/articles/5-things-you-should-know-about-geothermal-heat-pumps](http://www.energy.gov/eere/articles/5-things-you-should-know-about-geothermal-heat-pumps)

ii. [www.cityofmadison.com/finance/documents/budget/2024/capital/executive/ExecutiveSummaryFinal.pdf](http://www.cityofmadison.com/finance/documents/budget/2024/capital/executive/ExecutiveSummaryFinal.pdf)