



City of Patterson Finance Department

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MEMO

To: Fernando Ulloa, City Manager

Mike Willet, Assistant City Manager

From: Kevin Williams, Finance Director

Date: February 25, 2026

Subject: Accounting Treatment of IRS Inflation Reduction Act Tax Rebate for clean energy improvements

The Inflation Reduction Act (IRA) created a new mechanism known as Elective Pay (also referred to as “Direct Pay”), which allows tax-exempt entities, such as state and local governments, to receive refund payments from the IRS equal to the value of eligible clean energy tax rebates. Elective Pay is treated as a voluntary nonexchange transaction under GASB 33 because the City receives value (a refundable rebate) without providing equal value in return. Under GASB standards, revenue must be recognized when eligibility requirements are met. Because each fund is a separate fiscal and accounting entity under GASB Codification Section 1100, the rebate must be recognized in the same funds that incurred the qualifying solar expenditures. This treatment is consistent with GASB principles and protects the City from any potential Proposition 218 concerns.

Applicable Accounting Standards

The Governmental Accounting Standards Board (GASB) is the authority that sets Generally Accepted Accounting Principles (GAAP) for state and local governments in the United States. Governments must follow the rules and standards that are set by GASB or risk a multitude of consequences, including:

- Adverse Audit Opinions
- The loss of grant, Federal, or State funding
- Higher borrowing costs
- Potential violations of State Law
- Inconsistent or misleading financial information
- Damage to public confidence through a lack of transparency and comparability

The pertinent GASB rules and standards used in accessing how to account for the elective pay rebate are outlined below.

1. GASB Statement No. 33 – Voluntary Nonexchange Transactions

The IRS elective pay rebate is treated as a voluntary nonexchange transaction with reimbursement type eligibility requirements. Under GASB 33:

- Revenue is recognized when eligibility requirements are met (including incurring allowable costs) (Paragraphs 8-10 and 20-21).
 - Purpose restrictions do not affect the timing of recognition (paragraph 22)
- GASB 33 determines when revenue is recognized, but not which fund recognizes it.

2. GASB Fund Accounting Principles

- (Codification 1100) - GASB's Statement of Principles directs that governmental accounting "should be organized and operated on a fund basis," defining a fund as "a fiscal and accounting entity with a self-balancing set of accounts...segregated for the purpose of carrying on specific activities." This supports recording the rebate in the fund(s) whose resources and activities are affected (i.e., the funds that incurred the qualifying costs or will pay the related financing). Because the eligibility requirement of the elective pay rebate is the incurrence of allowable solar costs, and those costs occur at the fund level, the related revenue must be recognized in those same funds

Proposition 218 Concerns

Proposition 218 (the "Right to Vote on Taxes Act"), approved by California voters in 1996, limits local governments' authority to impose taxes, assessments, fees, and charges without voter approval. It added Articles XIII C and XIII D to the California Constitution. Proposition 218 brought about many changes for local governments, but the most important aspect of the proposition for this scenario is highlighted below:

1. Cost of Service Requirement:

- Property-related fees cannot exceed the reasonable cost of providing the service and must be proportional to the benefit provided.

Since Proposition 218 requires Enterprise fund rates to reflect only the actual cost of providing service, allocating the tax rebate exclusively to the General Fund would violate this requirement. The rebate represents cost offsets that properly belong in the Enterprise funds, which are financing the underlying improvements.

Recommended Allocation Approach

The City will allocate the IRS elective pay refund to the funds that incurred the qualifying expenditures using one of the following methods:

1. Proportional Cost Method

- Allocation based on each fund's share of eligible project cost or lease payments

2. Asset Location Method

- Allocation based on the fund that owns or operates the facility where the solar improvements are installed.

If the refund is initially deposited into a single fund, interfund transfers will be processed to distribute the revenue appropriately.

Conclusion

This approach ensures compliance with GASB 33 and GASB Fund level accounting principles while maintaining fairness between funds. It also protects the City from potential Proposition 218 violations and ensures accurate financial reporting.

A handwritten signature in blue ink, appearing to read "Kevin Williams", with a stylized flourish at the end.

Kevin Williams

Finance Director