Treasury, Internal Revenue Service Issue Final Regulations for Transfer of Energy Credits

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On April 25, 2024, the U.S. Department of Treasury (Treasury) and the Internal Revenue Service (IRS) issued final regulations regarding the transfer of energy tax credits under the Inflation Reduction Act of 2022 (IRA). Proposed regulations regarding transferability of energy tax credits were previously issued on June 21, 2023. The final regulations are generally the same as the proposed regulations with a few clarifications and differences. The final regulations become effective on July 1, 2024.

Section 6418 of the Internal Revenue Code (Code) provides that any taxpayer that is not an applicable entity under Section 6417 of the Code (previous articles on how applicable entities can use energy tax credits can be found here) can elect to transfer "all or any portion" of an eligible credit "determined with respect to" the eligible taxpayer for any tax year to an unrelated taxpayer. The taxpayer receiving the eligible credit through a transfer election, referred to as the transferee taxpayer, is treated as the taxpayer with respect to such eligible credit.

The eleven energy tax credits that may be transferred by an eligible taxpayer through a transfer election include the following credits:

1. Credits for alternative fuel vehicle refueling property (Section 30C),
2. Renewable electricity production credit (Section 45),
3. Credit for carbon dioxide sequestration (Section 45Q),
4. Zero-emission nuclear power production credit (Section 45U),
5. Clean hydrogen production credit (Section 45V),
6. Advanced manufacturing production credit (Section 45X),
7. Clean energy production credit (Section 45Y),
8. Clean fuel production credit (Section 45Z),
9. Energy investment tax credit (Section 48),
10. Qualifying advanced energy project credit (Section 48C), and
11. Clean electricity investment credit (Section 48E).

The amount of consideration paid by the transferee taxpayer for the eligible credit must be "paid in cash" and cannot be deducted by the transferee taxpayer. The eligible taxpayer does not include the consideration received in its gross income. Eligible credits can only be transferred one time.

The final regulations clarify several items that eligible taxpayers should be aware of such as rules for partnerships with applicable entities as partners, the "paid in cash" requirement, the specified credit portion rule, the "determined with respect to" requirements and other items worth exploring. These items will be discussed in the remainder of this article.

The final regulations provide that partnerships that have not made a direct pay election for Section 45V, Section 45Q, or Section 45X credits may qualify as an eligible taxpayer to make an election to transfer such credit under Section 6418 of the Code. However, for any partnership with partners that are applicable entities under Code Section 6417, the amount of eligible investment tax credit determined with respect to such applicable entity partners may be limited by Code Section 50(b)(3) and (4) (providing that credits are not allowed for property used by certain tax-exempt organization and governmental entities).

The final regulations adopt the "paid in cash" definition in the proposed regulations which requires the consideration paid by a transferee taxpayer to an eligible taxpayer for a transfer of an eligible credit must be paid in cash. The Treasury and IRS declined to include several comments that the paid in cash definition be revised to allow progress payments for the transfer of an eligible credit. Commenters stated that progress payments more closely align the timing of payments for eligible credits that are production tax credits with the timing of payments for eligible credits that are investment tax credits. Further, commenters stated that progress payments for production tax credits determined in future years is the standard structure in tax equity transactions. The final regulations affirm that there is no prohibition against a transferee taxpayer or a third party making a loan to an eligible taxpayer; however, in the preamble to the final regulations the Treasury and IRS noted that the treatment of such loans as progress payments for eligible credits is subject to a facts and circumstances analysis of the loan.

The final regulations clarify that an eligible taxpayer can transfer a specific portion of an eligible credit, but bonus credit amounts such as the domestic content bonus cannot be transferred separately from the base eligible credit. The specified credit portion rule requires that a specified credit portion of an eligible credit reflects a proportionate share of each bonus credit amount that is taken into account in calculating the entire amount of eligible credit.

The Treasury and IRS retained the provision of the proposed regulations requiring that the eligible credit be "determined with respect to" the eligible taxpayer for a transfer election to be allowed. Therefore the eligible taxpayer must own the underlying eligible credit property, or in the case of Section 45X conduct the activities giving rise to the eligible credit, to be able to make a transfer election. This rule prohibits a transfer election for credits acquired by a lessee from a lessor through a lease pass-through election or owned by a third party; however, the preamble to the final regulations clarifies that a transfer election can be made by the owner-lessor in a sale-leaseback transaction.

The final regulations also clarify that with respect to a Section 45Q (carbon dioxide sequestration) credit a taxpayer does not have to own every component of a single process train to be the taxpayer the Section 45Q credit is attributable to if such taxpayer also meets the requirements of Section 45Q(a) as applicable. Eligible credit property with respect to a Section 45Q credit is defined in the final regulations as a component of carbon capture equipment within a single process train.

The final regulations require an eligible taxpayer to complete the pre-filing registration process required of applicable entities making a direct payment election. The Treasury and IRS rejected comments to the proposed regulations calling for a streamlined registration process or the option to elect out of pre-filing registration and comments suggesting that transfers be allowed without a pre-filing registration, stating in the preamble that the pre-filing registration process ensured quality and accuracy of information provided. Similar to the approach in the Section 6417 direct pay final regulations, the final regulations

provide that the right to appeal a denial of a registration is limited and registering multiple facilities as a single project is prohibited.

Like previous IRA guidance from the Treasury and IRS, the final regulations hardly deviate from the proposed regulations and coincide with the direct pay final regulations on many issues. However, the release of the final regulations will help to further develop the growing market for transferring tax credits.