

Final Treasury Regulations Issued Governing Transfers of Renewable Energy Tax Credits

MAY 6, 2024

On April 25, 2024, IRS and Treasury issued final regulations under Code Section 6418 (the Final Regulations) governing the transfer and monetization of certain Tax Credits, as permitted under the Inflation Reduction Act of 2022 (P.L. 117-169) (the IRA). The Final Regulations substantially conform to the proposed regulations that were released on June 14, 2023 (the “Proposed Regulations”), with only minimal changes. Primarily the changes that were made provide clarification to the previously articulated rules, with only limited effect to substance.

BACKGROUND

The IRA created Code Section 6418, which allows eligible taxpayers to transfer for cash certain renewable energy related credits, including the energy investment credit and the new clean electricity investment credit (Code Sections 48 and 48E), the renewable energy production credit and the new clean electricity production credit (Code Sections 45 and 45Y), the carbon oxide sequestration credit (Code Section 45Q), the advanced manufacturing production credit (Code Section 45X), the clean hydrogen production credit (Code Section 45V), the qualifying advanced energy project credit (Code Section 48C), the credit for alternative fuel vehicle refueling property (Code Section 30C), the zero-emission nuclear power production credit (Code Section 48U), and the clean fuel production credit (Code Section 45Z).

Proposed Regulations addressing many issues not expressly covered by the text of Code Section 6418 were released June 14, 2023. Over the comment period following the release of the Proposed Regulations, extensive proposals and commentary were provided, many by market participants who sought changes that could reduce restrictions or otherwise shift risks in tax credit transfer transactions with the aim of accelerating and expanding the market. The IRS and Treasury, however, generally affirmed the rules as set forth in the Proposed Regulations, with only minor changes and clarifications, articulating their concern of containing risk of fraud and abuse, and maintaining ease of administrability for the government. Nevertheless, the finalization of these regulations has generally been received as a welcome step providing certainty, which is expected to help the already growing tax credit transfer marketplace as it enters its second year.

SOME NOTABLE HIGHLIGHTS FROM THE FINAL REGULATIONS AND THE PREAMBLE THERETO:

1. **Recapture Risk Remains on Buyer.** The Final Regulations retain the rules from the Proposed Regulations that generally the risk of recapture is borne by the transferee taxpayer (except for recapture under Code Section 50(a)

and 49(b) in connection with indirect transfers by partners in a partnership or S corporation shareholders). The Final Regulations do provide clarification, and an example, on how to allocate responsibility in cases where recapture is triggered by an indirect sale by a partner or S corporation shareholder and subsequently by a sale by the partnership or S corporation itself, and explain that where recapture has been triggered by an indirect sale by a partner or S corporation shareholder, the amount of ITC subject to recapture thereafter is reduced so as to avoid potential double recapture.

2. **Splitting Base and Bonus Credit Still Not Permitted (Horizontal Credit Transfers not permitted).** IRS and Treasury declined to expand the rules to permit transfers of base credit amounts separate from bonus credit amounts, instead retaining the Proposed Regulation's definition of "specified credit portion," which allows only for dividing up the amount of tax credit proportionately to the entire credit allowed, including both base credit amount and any qualifying bonus credit amounts.
3. **Advance Payments Still Not Permitted.** IRS and Treasury retained the rules from the Proposed Regulations governing when payments will be considered, as required, to be "paid as cash," including the safe harbor permitting payments made during the period starting on the first day of the seller's taxable year and ending on the earlier of the due date for the seller or buyer to file its annual tax return. The IRS notes in the Preamble to the Final Regulations, however, that transactions may be structured, consistent with these rules, that could allow for current payment of a loan to a tax credit transferor, secured by a tax credit purchase and sale agreement. The Preamble declines to provide any guidance on such transactions, stating that whether such transaction would be permitted or would be treated as impermissible "upfront payments for eligible credits or otherwise recharacterized," would depend on facts and circumstances and is outside the scope of these regulations.
4. **Code Section 469 Passive Credit Rules Apply to Transferred Tax Credits.** The Final Regulations re-affirm that transferred tax credits are subject to the Code Section 469 passive loss rules, which generally apply to individuals, estates, trusts, closely held C corporations and personal service corporations, and restrict their ability to use "passive losses" to shelter income from non-passive sources. Accordingly, taxpayers subject to the Code Section 469 rules generally will be limited in their ability to use transferred tax credits, which may limit the market of credit purchasers.
5. **Transfer of Credits by a Pass-through Lessee Not Permitted.** The Final Regulations do not extend the ability to make a tax credit transfer election to a lessee under a pass-through lease, potentially affecting the relative desirability of traditional alternative tax equity financing structures.
6. **Credit Transfers by Grantor Trusts.** The Final Regulations clarify that if a grantor trust owns eligible credit property, then an eligible taxpayer which is treated as the owner of the credit property held directly by that trust may make a credit transfer election under Section 6418.
7. **Credit Transfers by REITs.** The Final Regulations provide that eligible credits that have not yet been transferred will not cause a REIT to fail the REIT Asset Test under Code Sections 856(c)(4)(A) and 856(c)(4)(B), but instead will be disregarded for purposes of the REIT Asset Test. In addition, the final Regulations provide that a transfer of credits under Code Section 6418 is not treated as a sale of property for purposes of Code Sections 857(b)(6)(C)(iii) and 857(b)(6)(D)(iv).
8. **Transfer-Eligible Credit Property for purposes of Section 45Q Carbon Capture Credit.** The Final Regulations provide clarity on the definition of transfer eligible credit property with respect to the Carbon Oxide Sequestration Credit under Code Section 45Q. The Final Regulations provide that just as the Carbon Oxide Sequestration Credit under Code Section 45Q does not require a taxpayer to own the entirety of a single process train of carbon capture equipment to be eligible to claim the 45Q credit, but instead requires only that the taxpayer own at least one component thereof, so too may a single component within a single process train considered eligible credit property for purposes of Code Section 6418 credit transfer.

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