

IRS Issues Much-Anticipated Regulations for Transferrable Clean Energy Tax Credits

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The IRS recently issued proposed regulations describing rules for eligible taxpayers that may now elect to transfer certain clean energy credits to unrelated third parties under Section 6418 of the Internal Revenue Code (IRC) enacted under the Inflation Reduction Act (IRA). The clean energy tax incentive market is expected to increase to about \$50 billion in annual incentives during the next decade, and the objective of the proposed regulations is to stimulate the monetization of these credits to encourage investment in clean energy.

Tax Credit Investment Structures

Historically, the sale of federal renewable energy tax credits was prohibited, thus, developers of renewable energy projects were required to either (i) use the tax credits to offset their own tax liability; or (ii) enter into tax equity partnerships with third-party investors. Many developers will not have sufficient tax liability to utilize the credits and would prefer to monetize the credits. Admitting an investor into a tax credit partnership contains its own set of challenges including complex structuring and significant legal and accounting fees.

IRC Section 6418

The passage of Section 6418 of the IRC allows “eligible taxpayers” to elect to transfer certain credits to unrelated taxpayers rather than limiting the use to members of the project entity that generated the credits. Pursuant to Section 6418(a), an eligible taxpayer may elect to transfer to an unrelated transferee taxpayer all or any portion of an eligible credit. The eleven eligible credits include credits for renewable energy production, carbon oxide sequestration, zero-emission nuclear power production, clean hydrogen production, and investment in solar energy. Under the IRA, investment tax credits are equal to 30 percent of qualified expenditures for the years 2022 through 2032. Section 6418(b) provides that the consideration for the credits must be paid in cash, which amount is neither includable in the gross income of the transferor nor is allowed as a deduction to the transferee.

Buyer Eligibility

Taxpayers that are eligible to use these credits include partnerships, corporations, S corporations, individuals, and trusts. For determining a transferee's eligibility to purchase a tax credit, the transferee steps into the shoes of the transferor. However, because a transferee does not materially participate in the trade or business of the transferor, eligible credits that are purchased by individuals come through as passive activity credits and can only be used to offset tax on passive income.

Credits may only be transferred once, and as such, a transferee may not resell. Credits transferred under Section 6418 are available for use by the transferee beginning in the tax year in which the project is placed in service. Additionally, the credits have a three-year carryback and a 22-year carryforward.

Considerations for Buyers and Sellers

The pricing of transferrable tax credits depends on multiple variables, including the credit type, timing of payment, project location, and strength and indemnity of the sponsor. While discounts for buyers may range from 5% to 15%, the market for transferrable energy credits is still evolving. Sellers must take into consideration the balance of the costs and benefits of a tax credit equity partnership versus a sale. Sellers must be aware that IRC 50(c) applies to reduce the basis of the applicable energy property by 50% of the amount of the energy tax credit, as if such credit was allowed to the seller. Further, transferring tax credits may lead to the

inability to monetize tax depreciation deductions, and thus, Sellers may have to invest more money into their clean energy facilities. Sellers that may benefit most from transferring energy credits are those that seek to wait and transfer credits after determining their ability to use the credits, and developers of small facilities or facilities featuring lesser-known technologies that may lack access to traditional tax credit equity financing.

Buyers who have significant tax liability may benefit from the opportunity to purchase eligible tax credits at a discount. However, the buyer bears the financial responsibility for a recapture event and is required to recapture an amount of previously claimed tax credits based on the timing and the amount of the recapture event. The seller is required to notify the transferee if a recapture occurs. The proposed transfer regulations permit indemnification by the seller of recapture, so buyers must ensure that indemnification provisions are included in credit transfer agreements. Buyers should also confirm that a seller is eligible to transfer the credit.

The final rules and regulations from the IRS will be forthcoming to provide additional guidance for the program. For more information or assistance with transferring energy credits, please connect with the [Partridge Snow & Hahn Tax Credit Team](#).

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