Treasury Releases Proposed Regulations Addressing Transferability of Energy Tax Credits – Key Considerations for Buyers

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June 29, 2023 - On June 14, 2023, the Department of Treasury released proposed regulations (the "Proposed Regulations") that clarify the rules governing the transfer of green energy tax credits under the Inflation Reduction Act of 2022 (the "IRA"). Taxpayers may rely on the Proposed Regulations for taxable years beginning after December 31, 2022, provided that they follow the rules in their entirety and in a consistent manner. The IRA permitted developers with green energy projects to monetize their credits by selling them to unrelated parties, without utilizing the complex "tax equity" structure that was prevalent before the IRA.

The following green energy tax credits may be transferred under the IRA:

- the renewable electricity production credit (section 45);
- the carbon oxide sequestration credit (section 45Q);
- the zero-emission nuclear power production credit (section 45U);
- the clean hydrogen production credit (section 45V);
- the advanced manufacturing production credit (section 45X);
- the clean electricity production credit (section 45Y);
- the clean fuel production credit (section 45Z);
- the energy investment credit (section 48);
- the qualifying advanced energy project investment credit (section 48C);
- the clean electricity investment credit (section 48E); and
- certain alternative fuel vehicle refueling property credits (section 30C).

The Proposed Regulations provide guidance regarding the benefits and risks relevant to buyers of green energy tax credits. Some important considerations for potential buyers are highlighted below.

Paid-in-cash Requirement

Consideration for the transferred green energy tax credits must be "paid in cash". The Proposed Regulations require that a payment be made in U.S. dollars by cash, check, cashier's check, money order, wire transfer, automated clearing house (ACH) transfer, or other bank transfer of immediately available funds, within a specified period determined by reference to the time the credits are transferred. The regulations permit taxpayers to contractually agree to purchase future credits but do not permit prepayments.

Risk of Recapture

Buyers bear most of the risk of recapture with respect to acquired green energy tax credits. Generally, if a buyer acquires credits that would have been recaptured by the seller had the seller utilized the credits, the buyer is required to recapture the credits (a "Buyer Recapture Event"). For investment tax credits, for example, the property giving rise to the credits generally must remain in operation and be retained by the original owner for five years, with the credits vesting in equal annual installments. The carbon oxide sequestration credit also has a recapture period. Potential buyers of credits should carefully diligence the validity of credits, contractually prevent sellers from taking actions that could trigger a Buyer Recapture Event, and require a robust indemnity from the seller or reimbursement from an insurance provider if a Buyer Recapture Event occurs.

Where the seller is a partnership or S corporation, certain actions of the partners or shareholders could also trigger a recapture of the credits (a "Partner Recapture Event"). In that case, the Proposed Regulations provide that the relevant partners or shareholders, rather than the buyer, are required to recapture the credits. This sensible rule means that buyers do not need to diligence, and obtain covenants from, the seller's owners. The Proposed Regulations do not address whether a Partner Recapture Event reduces the amount to be recaptured as a result of a subsequent Buyer Recapture Event.

Excessive Credit Transfer

The Proposed Regulations penalize buyers who claim more green energy tax credits than they are entitled to claim (an "excessive credit transfer") by increasing the buyer's tax by the amount of the excessive credit transfer times 20 percent. However, the 20% penalty does not apply if the buyer demonstrates that the excessive credit transfer resulted from reasonable cause. Reasonable cause is determined based on a facts and circumstances test, with the most important factor being the level of diligence performed by the buyer to determine that the amount of the credits claimed is not more than the amount of the credits generated by (or with respect to) the underlying project.

Limitations on the Utilization of Acquired Credits

The Proposed Regulations provide that purchased green energy tax credits are treated as earned in connection with the conduct of a trade or business, but buyers are not treated as materially participating in the seller's business. As a result, a noncorporate buyer subject to the passive activity limitation rules must treat the purchased credits as passive activity credits. Buyers that are subject to the passive activity loss rules should ensure that any purchased credits are not subject to any limitations under those rules.

In addition, most of the green energy tax credits listed above cannot offset tentative minimum tax and are therefore of limited use to buyers that are subject to the alternative minimum tax. The energy investment tax credit and the renewable electricity production credit are exceptions to this rule and may offset the alternative minimum tax.

Green energy tax credits may be transferred only once. Buyers are not permitted to resell any of their acquired credits, and buyers that are partnerships are required to allocate the credits among the partners as of the time of acquisition of the credits.

No Gain Upon Utilization

The Proposed Regulations provide that buyers that purchase green energy tax credits at a discount (which is typically the case) are not required to recognize gain equal to the discount. The IRS is considering whether to allow buyers to claim a loss if the amount paid for the credits ultimately exceeds the total credits utilized, and how to treat buyers' transaction costs.

Conclusion

The IRA has created new opportunities for taxpayers to utilize green energy tax credits, but the rules for acquiring these credits are complex and limitations apply. Buyers should carefully examine the facts and circumstances surrounding any proposed green energy tax credit acquisition and are encouraged to reach out to us with any questions about these credits, including the process by which they may be purchased and claimed.

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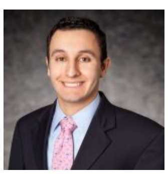

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