

Transferability of Energy Credits under the Inflation Reduction Act: What do you need to know?



Ashley Edwards

aedwards@mwlaw.com
(501) 688.8878



John Bryant

jbryant@mwlaw.com
(501) 688.8823

06/11/2024

Now that final regulations on the transferability of energy tax credits under the Inflation Reduction Act have been issued by the U.S. Department of Treasury (Treasury) and the Internal Revenue Service (IRS), many investors and developers are structuring and negotiating transactions to transfer energy tax credits. The final regulations were summarized in our recent article. However, this article will generally discuss the transferability of energy tax credits under the final regulations.

Section 6418 of the Internal Revenue Code (Code) authorizes eligible taxpayers to elect to transfer all or any portion of an eligible credit in any tax year. The credit may only be transferred to a taxpayer that is unrelated to the eligible taxpayer. An eligible taxpayer is defined in the final regulations as any taxpayer that is not an applicable entity under Section 6417(d)(1)(A), therefore, entities exempt from federal income tax such as state and local governments, non-profit corporations and other specified entities are not allowed to transfer eligible credits. The options for applicable entities to take advantage of energy tax credits have been addressed in prior articles.

The eleven energy credits that are “eligible credits” for the purpose of an election to transfer 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 taxpayer receiving the eligible credit from the eligible taxpayer through a transfer, referred to as the transferee taxpayer, can claim the transferred eligible credit on its tax return; however, an eligible credit can only be transferred by a transfer election one time. Therefore, the transferee taxpayer cannot make a transfer election for any portion of an eligible credit it receives from an eligible taxpayer through a transfer election.

Under Section 6418(b) any amount of consideration paid by the transferee taxpayer for the transfer of the eligible credit must be paid in cash. The consideration received by the eligible taxpayer is not included in the eligible taxpayer's gross income. The transferee taxpayer is not allowed to take a deduction for the amount of consideration paid for the eligible credit transfer.

The eligible taxpayer must make a transfer election on an original tax return for the tax year in which the eligible credit is determined meaning the transfer election must be made by the due date of the original tax return of the eligible taxpayer including extensions and cannot be made on an amended return. A transfer election cannot be revoked after it has been made by the eligible taxpayer.

An eligible taxpayer wanting to make a transfer election must complete the IRS online pre-filing registration process and receive a registration number from the IRS for the eligible credit property.

The transferee taxpayer must receive from the eligible taxpayer the registration number for the eligible credit property along with additional required supporting documentation specific to the eligible credit in order to claim the transferred eligible credit on its tax return. Required supporting documentation includes information validating the existence of the eligible credit property, substantiation that eligible taxpayer satisfied requirements related to any bonus credit amounts such as the prevailing wage and apprenticeship bonus and the domestic content bonus, and evidence of the eligible taxpayer's qualifying costs related to the eligible credit property.

The eligible taxpayer and the transferee taxpayer will also need to complete a transfer election statement together and attach it to their respective tax return. This statement must include the name, address, and taxpayer identification number for the eligible taxpayer and the transferee taxpayer, a description of the type and amount of the eligible credit being transferred, the tax year of the eligible taxpayer and the first tax year in which the eligible credit will be claimed by the transferee taxpayer, the timing and amount of cash being paid by the transferee taxpayer, the registration number related to the eligible credit property, and several representations by the eligible taxpayer and/or the transferee taxpayer as provided in the final regulations.

The final regulations provides that transferee taxpayer is liable for recapture of the credits received through a transfer. Recapture applies to credits that are investment tax credits such as tax credits under Sections 48, 48E or 48C but does not apply to production tax credits (except for the carbon sequestration credit under Section 45Q which has a 3-year recapture period). If a recapture event occurs, the transferee taxpayer is required to recapture an amount of previously claimed tax credits based on the timing and the amount of the recapture event. However, recapture liability applies proportionately to an eligible taxpayer and any transferee taxpayers to the extent an eligible taxpayer has retained eligible credits. A recapture event occurs if the qualifying energy asset is disposed of, sold, or ceases operations within the first five years after being placed in service. However, if a disposition of an ownership interest in the eligible taxpayer occurs, the owner of such interest, not the transferee taxpayer, is liable for the recapture.

If a recapture event occurs, the eligible taxpayer is required to notify the transferee taxpayer and then the transferee taxpayer is required to notify the eligible taxpayer of the amount of any recapture. These notices must be exchanged before the due date of the eligible taxpayer's and transferee taxpayer's federal income tax returns without being extended. The time of the exchange must allow enough time for the transferee taxpayer to calculate the recapture amount and the eligible taxpayer to calculate any

increase in the tax basis of the qualified energy property resulting from the recapture before their respective returns are due.

In addition to recapture, a transferee taxpayer is liable for any excessive credit transfer. An excessive credit transfer occurs when a transferee taxpayer claims more credits than are otherwise allowable to the eligible taxpayer with respect to the eligible credit property. In such event, the transferee taxpayer will be required to pay to the IRS a tax equal to the excess amount of the credit claimed plus 20% of the excess amount. The final regulations provide that a recapture event is not an excessive credit transfer so the excessive credit transfer rules operate independently of the recapture rules. If a transferee taxpayer can show reasonable cause for an excessive credit transfer, the 20% penalty may be removed by the IRS.

The final regulations allow the IRS to disallow the transfer of an eligible credit or to recharacterize the income tax consequences of a transfer transaction. This may occur in situations where parties to a transfer transaction have engaged in one or more transactions with the sole purpose of avoiding tax liability beyond the intent of Section 6418. Eligible taxpayers and transferee taxpayers must be careful to separate the economic consideration of the credit transfers from other activities between the parties that produce income.

The new transferability of energy tax credits is a helpful tool for those entities that have not otherwise been able to take advantage of the benefits of energy tax credits; however, there are many rules that must be complied with by the eligible taxpayer and the transferee taxpayer to be able to enjoy those benefits. Careful consideration of these rules must be taken by all parties involved in the transfer of energy tax credits under the IRA.