Renewable Tax Credit Transfers: Overview and Deal Considerations

By Renisha Ricks, Andrea S. Kramer, and Nicholas C. Mowbray

I. Introduction

The Inflation Reduction Act (IRA)[1] modified and reinstated existing renewable energy credits, introduced new renewable energy credits, and enacted under Code Sec. 6418[2] an election that allows eligible taxpayers to sell certain credits on a one-time basis for cash.[3] The one-time transfer provision provides a new and novel source of capital to developers and owners of renewable energy projects, allowing them to monetize eligible credits and use the capital to either repay project-level debt or make cash distributions to investors.[4] As a result, a transfer market and commercial deal terms for renewable energy credits have started to develop. In this article, we examine key provisions of the final regulations and emerging market practices for renewable credit transfer transactions.

II. Background

A. Definitions

The one-time transfer rules permit "eligible taxpayers" that own certain renewable energy credits to transfer a proportionate amount of a renewable energy credit to a buyer in exchange for cash.[5] An eligible taxpayer is defined as a taxpayer that is not a tax-exempt organization, a state or political subdivision thereof, the Tennessee Valley Authority, an Indian tribal government, an Alaska Native Corporation, or an electric energy cooperative. Cash is defined as U.S. dollars, a check, a cashier's check, money order, wire transfer, automated clearing house (ACH) transfer, or another bank transfer of immediately available funds.[6] Cash equivalents and other forms of payment are not permitted. Cash receipts received for a sale are not includible in the eligible taxpayer's gross income, and payments are not deductible by the buyer.[7] If transferable credits are sold for less than their face amount, the eligible taxpayer does not recognize the discount value as taxable income.

Transferable credits are those credits listed below in Table 1. A partnership or an S corporation that directly holds transferable credits can make a transfer election. Partners, however, cannot make the election for the entity itself.[8] If a partnership

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TABLE 1.	
Code Sec. 30C	Alternative Fuel Vehicle Refueling Property Credit
Code Sec. 45	Electricity Production Tax Credit
Code Sec. 45Q	Carbon Oxide Sequestration Credit
Code Sec. 45U	Zero-Emission Nuclear Power Production Credit
Code Sec. 45V	Clean Hydrogen Production Tax Credit
Code Sec. 45X	Advanced Manufacturing Production Credit
Code Sec. 45Y	Clean Electricity Production Credit or CEPTC
Code Sec. 45Z	Clean Fuel Production Credit
Code Sec. 48	Energy Investment Tax Credit
Code Sec. 48C	Advanced Energy Project Credit
Code Sec. 48E	Clean Electricity Investment Credit or CEITC

(or S corporation) sells credits, the sale generates tax-exempt income treated as income from an investment, not from a trade or business. A partner's (or shareholder's) distributive share is treated as tax-exempt income that is allocated to the partners (or shareholders) in the same proportionate amount as they would have received if the transferable credit had not been sold.

Bonus credit amounts are treated as *additions* to base credit amounts. They cannot be sold separately from the base credits that they relate to. Although an eligible taxpayer can sell a portion (that is, a percentage) of its overall tax credits, it cannot separate the base credits from bonus credits to sell as separate credits.[9]

B. Treasury Regulations

The Internal Revenue Service (IRS) and the Treasury Department on April 25, 2024, published final regulations relating to the one-time transfer election under Code Sec. 6418.[10] The final regulations under Code Sec. 6418 were issued approximately seven weeks after the final regulations under Code Sec. 6417, relating to direct pay. Both sets of regulations provide important guidance for taxpayers interested in monetizing certain renewable energy credits. What follows are the major points and key insights into the final regulations under Code Sec. 6418.

III. The Complexities of Code Sec. 6418

A. Eligibility Criteria and Transfer Mechanics

Credits are determined for each single eligible credit property and an eligible taxpayer may only transfer eligible credits that are generated either by eligible credit property owned by the eligible taxpayer or by conduct of the eligible taxpayer that gives rise to the underlying eligible credit.[11]

B. Carrybacks and Carry Forwards

The final regulations allow a three-year carryback for credits under Code Secs. 30C, 45, 45Q, 45U, 45V, 45X, 45Y, 45Z, 48, 48C, and 48E acquired by transfer.[12] Additionally, the final regulations clarify that transferee taxpayers can carry forward an unused credit amount.[13]

C. Brokers and Dealers

Several commenters sought an exemption from the one-time transfer restriction to permit transfers to brokers or dealers, followed by a subsequent transfer by those brokers or dealers. The final regulations, however, did not amend the rules to allow for this.[14] Instead, the Preamble confirms that any taxpayer that receives a specified credit portion under Code Sec. 6418 is not permitted to execute a second transfer.[15]

D. Financial Structures and Anti-Abuse Provision

Payments for transferred credits must relate to the specified credit portion and must be paid in U.S. dollars, including by check, cashier's check, money order, wire transfer, ACH transfer, or other bank transfer of immediately available funds.[16] A credit may be purchased in the year that the credit is generated and until the due date (including extension) for the eligible taxpayer's federal income tax return.[17] Contractual commitments to purchase eligible credits are permissible in advance of the date when the specified credit is purchased, but all the payments must occur between the first day of the eligible taxpayer's taxable year during which the specified credit is generated and ending by the date (including extensions) of the eligible taxpayer's federal income tax return.[18] Loans from transferees to eligible taxpayers are permitted if they are at arm's length and treated as loans for tax purposes.[19] The regulations clarify that transfers with "a" principal purpose of tax avoidance are disallowed, and transfers deviating from average prices may invite IRS scrutiny.[20]

E. Election Process and Documentation Requirements

1. Election Process

There is no limitation on the number of transfer elections or the number of transferee taxpayers for which an eligible taxpayer may make a transfer election unless the transfer would exceed the available eligible credit to be transferred.[21]

a) Lease passthrough elections. One commenter to the proposed regulations requested that a lessee which makes a lease passthrough election under former §48(d) be allowed to make a transfer election with respect to investment tax credits it can claim. The Preamble, though, notes that in order to make a one-time transfer election, the eligible credit must be determined with respect to the eligible taxpayer making the transfer election, and a lessee would not satisfy this requirement. Thus, the final regulations do not amend the proposed regulations.[22]

b) Made on original return. The final regulations adopt the proposed regulations' requirement that a one-time transfer election be made on an original filed return (including time extensions).[23] The final regulations, however, note three additional points. First, an eligible taxpayer may make or revise a one-time transfer election on a superseding return but not an amended return. Second, a taxpayer may correct a numerical error on an amended return. And third, a taxpayer may request relief under Reg. §301.9100-2(b) if the taxpayer timely filed a return and takes corrective action within the six-month extension period.[24]

c) Manner of election. In general, a taxpayer makes a valid transfer election as part of filing a return and must include with its return (1) a properly completed relevant source credit form for the eligible credit; (2) a properly completed IRS Form 3800, *General Business Credit*, including reporting the registration number received during the required prefiling registration and a schedule attached to Form 3800 showing the amount of eligible credit transferred for each eligible credit property; and (3) a transfer election statement.[25]

d) Transfer election statement. The transfer election statement is a written document that describes the transfer of a specified credit portion.[26] The statement must include (1) the name, address and Taxpayer Identification Number of the transferee and the eligible taxpayer; (2) information and amounts related to the specified credit portion and eligible credit property, including (a) a description of the eligible credit, the total amount of the credit determined with respect to the eligible credit property and the amount of the specified credit portion; (b) the taxable year of the eligible taxpayer and the first taxable year in which the specified credit portion will be taken into account by the transferee; (c) the amount of cash consideration and the date it was paid; and (d) the registration number related to the eligible credit property; (3) a statement that the parties are not related; (4) a statement from the eligible taxpayer that they have complied with all relevant requirements to make a transfer election and that they are aware of the recapture requirements; and (5) a statement or representation from the eligible taxpayer that they have provided the minimum documentation to the transferee that validates the existence of the eligible credit property, any bonus credit amounts and evidence of credit qualification. Any document, including a written partnership agreement, may serve as a transfer election statement so long as it meets the requirements under the final regulations.[27]

The final regulations under Code Sec. 6418 provide comprehensive guidance for transferring renewable energy credits, addressing eligibility, transfer mechanics, and compliance requirements. Taxpayers must carefully navigate these rules to effectively monetize energy credits while adhering to regulatory standards.

e) Timing for transfer election statement

(i) Timing. The transfer election statement must be completed before the earlier of when the eligible taxpayer files its return for the taxable year for which the specific credit portion is determined or the transferee files its return for the taxable year in which the specified credit portion is taken into account.[28]

(ii) Elections—property or facility basis. Elections to transfer credits under Code Secs. 30C, 48, and 48C are made on a property-by-property basis, while credits under Code Secs. 45, 45U, 45V, 45X, 45Y, 45Z, and 48E are made on a facility-by-facility basis.[29] Elections to transfer credits under Code Sec. 45Q are made on a unit-by-unit basis.

F. Passive Activity Rules and Income Inclusions

1. Passive Activity Rules

Transferred credits are generally treated as earned in connection with the conduct of a trade or business and they are, therefore, subject to the passive activity rules under Code Sec. 469.[30] The final regulations do not waver on this point and instead state that nothing in Code Sec. 6418 supports disregarding the passive activity rules. The IRS and Treasury go on to note that a transferred specified credit portion is not determined in connection with the conduct of an investment or as a capital asset.

2. Income Inclusions

a) Discounts. Transferees that acquire an eligible credit at a discount (*i.e.*, the amount paid for the eligible credit is less than the amount of the eligible credit claimed) are not required to recognize income as a result of the discount.[31] The Preamble discusses case law addressing bargain purchases, noting that the final regulations do not conflict with the case law, and explaining that any discounted purchase merely reflects the assumption of risk that a transferee taxpayer is taking on by purchasing a credit.[32]

b) Partner's distributive share. A partner's distributive share of tax-exempt income resulting from the receipt of cash by a transferor partnership for a transfer-specified credit portion is based on the partner's proportionate distributive share of the eligible credit.[33] The final regulations confirm that a partnership agreement may be revised up until the due date of the partnership's annual tax return to address the portion of each partner's eligible credit amount to be transferred and the portion of each partner's eligible credit amount to be retained and allocated.[34]

G. Logistics on Transfers

1. Transfers by Disregarded Entities

The owner of a disregarded entity is eligible to make the transfer election under Code Sec. 6418.[35]

2. Minimum Documentation

An eligible taxpayer is required to provide minimum documentation to a transferee. This includes (1) information that validates the existence of the eligible credit property, which could be prepared by a third party; (2) information substantiating any bonus credit amounts; and (3) evidence of the eligible taxpayer's qualifying costs or qualifying production activities.[36]

H. Year Taken into Account

1. First Taxable Year

A transferred credit is taken into account by a transferee in the first taxable year of the transferee ending with the taxable year of the eligible taxpayer in which the credit was determined.[37] The Preamble provides an example of when an eligible taxpayer has a June 30 year-end and a transferee taxpayer has a December 31 year-end.[38] The example notes that the relevant credit is transferred in November 2023 and states that the transferee would take the transferred credit into account in its first taxable year ending after June 30, 2024.

2. Estimated Tax Payments

The Preamble to the final regulations reiterates that a transferee may also take into account a specified credit portion that it has purchased, or intends to purchase, when calculating its estimated federal income tax payments.[39] However, the final regulations do not add a specific rule addressing this.[40]

I. Excess Credit Transfers

1. Liability and Penalties for Excess Credits

The transferee, not the eligible taxpayer, is liable for additional tax and penalties if the amount of the transferred specified credit portion claimed by the transferee taxpayer exceeds the allowable amount of the credit.[41]

2. Deductibility of Payments—Excess Transfers

The final regulations also addressed instances where a transferee taxpayer purchased a credit that is ultimately denied and whether the payment should then be deductible by the taxpayer. The final regulations provide that any payment made by a transferee taxpayer that relates to an excessive credit transfer is deductible.[42]

J. Risk Management and Indemnity Provisions

1. Diligence

Tax credit buyers should expect to perform detailed due diligence with respect to the underlying project's tax credit qualifications and amounts.[43] Sellers should be prepared to provide documentation and third-party verification of critical facts, including compliance with prevailing wage and apprenticeship requirements, third-party verification of the nature and amount of costs or production through a cost segregation report, an appraisal supporting any basis step-up transaction, and documentation supporting bonus credit qualifications such as domestic content or energy communities. Additionally, a seller should be prepared to document how it met the beginning of construction requirements and documentation around the placed-in-service date for the project.

2. Indemnification Requirements

In renewable energy credit transfers, indemnification clauses have developed as crucial tools for managing risk. The complexities of Code Sec. 6418 transactions and strict IRS compliance standards necessitate shielding buyers from financial and legal exposure stemming from credit disallowance or changes in existing tax law.

A well-drafted indemnification provision typically requires the seller to reimburse the buyer for any liabilities resulting from a disallowed credit, including the purchase price, penalties, interest, and legal fees incurred during disputes. Sellers may need to indemnify a buyer in the event there are inaccuracies in the documentation or registration processes required to support the validity of the transferred credits, or in the event that the IRS disallows transferred credits due to non-compliance.[44]

Indemnification clauses should remain in effect for the duration of the applicable statute of limitations and the recapture period to protect buyers from potential IRS challenges. There are also considerations relating to whether the buyer or seller will control legal decisions in the event of an IRS audit that challenges the relevant credits. In general, the buyer should control the legal decisions but needs the seller's consent for certain actions, such as settling the disputed credit amount.

3. Tax Insurance

To further mitigate risks, the regulations acknowledge the use of tax insurance policies. These policies are crucial in renewable energy credit transfers, providing coverage against the financial consequences of credit disallowance, including penalties and legal costs. For buyers, tax insurance offers additional security that extends beyond the indemnification obligations of the seller. Sellers, in turn, can leverage tax insurance to enhance the attractiveness of their credits, often commanding higher purchase prices for the reduced risk profile.

When integrating tax insurance into credit transfer agreements, policies must explicitly cover risks like "beginning of construction" or recapture and list the buyer as a primary beneficiary. Sellers generally procure and maintain the policies for the duration of the IRS review period. Although the cost of such policies can be substantial, they are considered essential for ensuring taxpayer compliance and market confidence.

In many cases, tax insurance has become critical in the structuring of tax credit transfers, with buyers often requiring proof of coverage as a condition precedent to the closing of a credit transfer agreement. This trend highlights the growing importance of financial risk management tools in renewable credit transfer transactions.

K. Registration

1. Timing

Eligible taxpayers must register before filing the tax return on which a transfer election is made.[45] If they do not, they cannot transfer an otherwise eligible credit.

2. Prefiling

Eligible taxpayers must register eligible credit property through the IRS portal to receive a unique registration number for each registered eligible credit property for which they intend to transfer a specified credit portion.[46] The Preamble to the final regulations notes that for some eligible credits, the prefiling registration portal allows eligible credit property information to be uploaded by way of a spreadsheet, but the Preamble does not allow taxpayers to group their registrations.[47]

3. Requirements

The prefiling registration requirements provide that an eligible taxpayer must (1) complete the prefiling registration process electronically through the IRS electronic portal;

(2) satisfy the registration requirements prior to making a transfer election; (3) obtain a registration number for each eligible credit property; and (4) provide the specific information required to be provided as part of the prefiling registration process to the IRS.[48]

IV. Conclusion

The final regulations under Code Sec. 6418 provide comprehensive guidance for transferring renewable energy credits, addressing eligibility, transfer mechanics, and compliance requirements. Taxpayers must carefully navigate these rules to effectively monetize energy credits while adhering to regulatory standards. Required full indemnity clauses for buyers enhance the security and viability of these transactions, strengthening energy credit market confidence. Additionally, tax insurance policies offer further protections, allowing both parties to engage in credit transfers with greater assurance.

ENDNOTES

1 P.L. 117-169, 136 Stat. 1818 (2022).
2 All "§," "Section," "I.R.C.," or "Code" references are to the Internal Revenue Code of 1986, as amended to date, or to the U.S. Treasury Department Regulations (Treasury Regulations), as most recently adopted or amended, unless otherwise noted.
3 Credits that are eligible for transfer include Code Sec. 30C (alternative fuel vehicle refueling property), Code Sec. 45 (renewable electricity production), Code Sec. 45Q (carbon oxide sequestration), Code Sec. 45U (zero-emission nuclear power production), Code Sec. 45V (clean hydrogen production), Code Sec. 45X (advanced manufacturing production), Code Sec. 45Y (clean electricity production), Code Sec. 45Z (clean fuel production), Code Sec. 48 (energy investment), Code Sec. 48C (advanced energy project), and Code Sec. 48E (clean electricity investment).
4 Transfer of Certain Credits, 89 FR 34,770 (Apr. 30, 2024).
5 Code Sec. 6418.
6 Reg. §1.6418-1(f)(1).
7 Code Secs. 6418(b)(2) and (3).
8 Code Sec. 6418(c).
9 Fed. Reg. pmbl.
10 89 FR 34,770 (Apr. 30, 2024).
11 Reg. §§1.6418-1(d) and 1.6418-2(d).
12 Reg. §1.6418-5(h).
13 Reg. §1.6418-5(h).
14 Reg. §1.6418-1(f)(1).
15 Fed. Reg. pmbl.
16 89 FR 34,770, 34,773 (Apr. 30, 2024).
17 Reg. §1.6418-1(f)(2).
18 Reg. §1.6418-1(f)(3).
19 89 FR 34,770, 34,773 (Apr. 30, 2024).
20 89 FR 34,770, 34,781 (Apr. 30, 2024).
21 Reg. §1.6418-2(a)(2).
22 89 FR 34,770 (Apr. 30, 2024).
23 Reg. §1.6418-2(b)(4).
24 *Id.*
25 Reg. §1.6418-2(b)(4)(i).
26 Reg. §1.6418-2(b)(5).
27 Reg. §1.6418-2(b)(5)(i).
28 Reg. §1.6418-2(b)(4)(i).
29 Reg. §1.6418-1(d).
30 Reg. §1.6418-2(f)(3).
31 Reg. §1.6418-2(f)(2).
32 89 FR 34,770, 34,781 (Apr. 30, 2024).
33 Reg. §1.6418-3(b)(1).
34 89 FR 34,770, 34,787 (Apr. 30, 2024).
35 Reg. §1.6418-2(a)(3).
36 Reg. §1.6418-2(b)(5)(iv).
37 Reg. §1.6418-2(f)(1).
38 Fed. Reg. pmbl.
39 *Id.*
40 89 FR 34,770 (Apr. 30, 2024).
41 Reg. §1.6418-5(a)(1).
42 Reg. §1.6418-5(a)(3).
43 89 FR 34,770, 34,793 (Apr. 30, 2024).
44 *See* Code Sec. 6418(g)(2)(A).
45 Reg. §1.6418-4.
46 IRS Publication No. 5884 (2023), Inflation Reduction Act (IRA) and CHIPS Act of 2022, Pre-Filing Registration Tool.
47 Fed. Reg. pmbl.
48 89 FR 34,770, 34,812 (Apr. 30, 2024).