

IRS Releases Major Regulatory Package on Energy Tax Credit Monetization

June 20, 2023

One of the most innovative features of the energy tax credit provisions of the Inflation Reduction Act (the “IRA”), which became law on August 16, 2022, is a pair of provisions that allow taxpayers to sell energy tax credits to a third party for cash (Section 6418) or to elect to receive a cash payment of the tax credit directly from the federal government (Section 6417).¹ Since the IRA was enacted, taxpayers, tax-exempt organizations, governmental entities, and their advisors have been counting the days for the IRS to provide guidance on how to apply these monetization provisions, which are expected to be a game-changer in the U.S. market for investment into green energy technologies.

The IRS released a major package of temporary and proposed regulations on these provisions on June 14, 2023. The package consisted of (i) temporary regulations requiring taxpayers to register their intent to elect direct payment of a tax credit or to transfer a tax credit on a new online portal to be established for this purpose (the “Temporary Registration Portal Regulations”), (ii) proposed regulations on the direct pay provisions under Section 6417 (the “Proposed 6417 Regulations”), (iii) proposed regulations on the tax credit transfer provisions under Section 6418 (the “Proposed 6418 Regulations”), and (iv) proposed regulations on the direct pay provisions for the Advanced Manufacturing Investment Credit under the Creating Helpful Incentives to Produce Semiconductors Act of 2022 (such Act, the “CHIPS Act,” and such regulations, the “Proposed CHIPS Act Regulations”). The IRS requests that any comments on this package of regulations be provided by August 14, 2023.

The Proposed 6417 Regulations, Proposed 6418 Regulations, and Proposed CHIPS Act Regulations are generally effective for tax years ending on or after the date that the final regulations are published in the *Federal Register*. Taxpayers may also rely on the proposed regulations for tax years beginning after December 31, 2022, as long as the proposed regulations are followed in their entirety and in a consistent manner.

The Temporary Registration Portal Regulations are effective for tax years ending on or after the date that they are published in the *Federal Register* and are scheduled to expire on June 12, 2026.

This Client Alert describes some of the more significant provisions of this regulatory package.

Direct Pay Provisions

Historically, tax-exempt entities have not been able to benefit from tax credits, because tax-exempt entities generally do not have any tax liabilities against which a tax credit can be used as an offset. The IRA changed this situation by allowing certain tax-exempt entities (referred to as “Applicable Entities”) to elect to receive a cash payment of certain energy tax credits directly from the federal government. The IRA provides that Applicable Entities are (i) any organization that qualifies for exemption from income taxation under the Code, (ii) any U.S. state or political subdivision thereof, (iii) the Tennessee Valley Authority, (iv) certain Indian tribal governments, (v) any Alaska Native Corporation, and (vi) certain rural electric energy cooperatives. Applicable Entities are eligible to elect direct pay for certain specified energy tax credits that are listed in Section 6417.²

In addition, any taxpayer (not just Applicable Entities) can elect direct pay for the Clean Hydrogen Production Credit under Section 45V, the Carbon Oxide Sequestration Credit under Section 45Q, and the Advanced Manufacturing Production Credit under Section 45X. The Proposed 6417 Regulations refer to taxpayers that elect direct pay for tax credits under Sections 45V, 45Q and 45X as “Electing Taxpayers.”

If the owner of a project makes a direct pay election, the project is subject to the same recapture and basis adjustment provisions that apply with respect to tax credits for which no direct pay election is made. For example, under Section 50, the basis of property with respect to which a tax credit is determined is reduced by the amount of the tax credit (and, in the case of an investment tax credit, the basis of the relevant property is only reduced by 50% of the tax credit).

Some significant provisions of the Proposed 6417 Regulations are described below:

Applicable Entities

The Proposed 6417 Regulations clarify that, in addition to states and their political subdivisions, Applicable Entities also include governmental agencies and instrumentalities. This taxpayer-favorable rule will permit direct payment for an even wider range of entities than was initially expected.

The Proposed 6417 Regulations also clarify that the governments of the District of Columbia and the territories of the United States (and their political subdivisions), as well as political subdivisions of Indian tribal governments, are Applicable Entities for the purposes of Section 6417. In addition, the Proposed 6417 Regulations clarify that a disregarded entity owned by an Applicable Entity or Electing Taxpayer is eligible to make a direct pay election.

Chaining

Commentators requested clarification on whether an Applicable Entity or Electing Taxpayer could elect direct pay for a tax credit that was acquired from another party, for example as the result of a transfer under Section 6418 (referred to as “chaining”). The Proposed 6417 Regulations provide that only the Applicable Entity or Electing Taxpayer that owns the underlying property or conducts the activities giving rise to the tax credit can elect direct pay, and accordingly chaining is not permitted (although the IRS requests further comment on the issue). This rule is not surprising, as the alternative seems to reduce the role of an Applicable Entity or Electing Taxpayer to a kind of accommodation party.

Partnerships and S Corporations

The IRA provides that, in the case of a partnership or S corporation, a direct pay election must be made by the partnership or S corporation (and not the partners or shareholders). The payment, which would be made directly to the partnership or S corporation, is treated as tax-exempt income by the recipient.

The Proposed 6417 Regulations provide that a partnership or S corporation cannot be an Applicable Entity, and therefore can only qualify as an Electing Taxpayer. Accordingly, a partnership or S corporation can only elect direct pay for the Clean Hydrogen Production Credit under Section 45V, the Carbon Oxide Sequestration Credit under Section 45Q, and the Advanced Manufacturing Production Credit under Section 45X.

Making the Direct-Pay Election

In order to make a direct pay election, an Applicable Entity or Electing Taxpayer must (a) obtain a pre-filing registration number (described under “New Tax Credit Registration System” below), (b) make the direct pay election on an original tax return (*i.e.*, not on an amended tax return), (c) complete any relevant source credit forms and IRS Form 3800, *General Business Credit*, and (d) provide certain supporting information and calculations.

If the Applicable Entity or Electing Taxpayer is required to file an annual federal income tax return, the direct pay election must be made no later than the due date (including extensions of time) for the taxpayer’s federal income tax return for the taxable year in which the election is made. If an entity is not required to file an annual federal income tax return (such as a governmental entity) the direct-pay election must generally be made no later than the due date (including any extension of time) that would apply if the entity were required to file an annual federal income tax return under the rules for tax returns of tax-exempt organizations (generally, the 15th day of the fifth month after the end of the tax-exempt organization’s taxable year). The Proposed 6417 Regulations provide that there is no 9100 late filing relief for a late direct pay election.

If the amount of the direct payment is determined to be excessive, the Applicable Entity or Electing Taxpayer would owe the federal government the excessive payment plus a 20% penalty.

Transferability Provisions

The second monetization provision added by the IRA, in Section 6418, gives certain taxpayers the ability to transfer (*i.e.*, sell) certain tax credits to other persons in exchange for cash. Under this provision, any taxpayer that is not an Applicable Entity (referred to as an “Eligible Taxpayer”) can transfer a tax credit to a transferee in exchange for a cash payment. The Eligible Taxpayer is not subject to federal income tax on that payment. The transferee cannot be related to the Eligible Taxpayer, and the transferee cannot transfer the tax credit to another person or (as noted above) elect direct pay for a transferred tax credit by chaining.

Transferability is only available for specified tax credits listed in Section 6418.³ There is no requirement under Section 6418 that the amount paid by the transferee equals the amount of the tax credit, and in fact practitioners generally expect tax credits to trade at a discount under this provision.

Some important provisions of the Proposed 6418 Regulations include the following:

Multiple Transferees

While a tax credit can only be transferred once, the Proposed 6418 Regulations allow an Eligible Taxpayer to divide that one tax credit into “specified portions,” which may be transferred to multiple transferees. A specified portion of a tax credit must include a proportionate share of all base and bonus credit amounts that make up the tax credit — *i.e.*, an Eligible Taxpayer cannot transfer a base credit to one transferee and a bonus credit to a different transferee.

Treatment of Payments

The Proposed 6418 Regulations address certain issues that arise when the amount of a payment for a transferred tax credit does not equal the amount of the tax credit itself. Specifically, the Proposed 6418 Regulations provide that a transferee does not realize taxable income if it pays less for the tax credit than the amount of the credit that is actually received. On the other hand, the Proposed 6418 Regulations do not provide a rule regarding whether a transferee can deduct a loss if the amount paid for the tax credit turns out to be more than the amount of the tax credit that the transferee can ultimately claim. The IRS asks for comments on whether such a loss should be deductible.

Transfers for Cash

Section 6418 provides that any payment in exchange for a tax credit must be made solely for cash. The Proposed 6418 Regulations provide that a cash payment includes payments by cash, check, cashier’s check, money order, wire transfer, automated clearing house (ACH) transfer, or other bank transfer of immediately available funds. Taxpayers may enter into a contractual commitment to purchase a tax credit before the tax credit is determined, but the actual payment of cash must not be made either before the first day of the Eligible Taxpayer’s tax year in which the tax credit is determined or after the due date of the transfer election statement described below (*i.e.*, the earlier of the filing of the Eligible Taxpayer’s tax return for the taxable year in which the tax credit is determined or the filing of the transferee’s tax return for the year in which the tax credit is taken into account).

Making the Transfer Election

An Eligible Taxpayer must (a) obtain a pre-filing registration number (described under “New Tax Credit Registration System” below), (b) make the transfer election on its annual tax return, (c) include a “transfer election statement” as described below, (d) complete the relevant source credit form and IRS Form 3800, *General Business Credit*, and (e) provide certain supporting information and calculations. Generally speaking, the election must be made by the Eligible Taxpayer for each eligible facility or credit property no later than the due date (including extensions of time) for the Eligible Taxpayer’s original return for the taxable year for which the election is made (*i.e.*, not on an amended return). The Proposed 6418 Regulations provide that there is no 9100 late filing relief for a late transfer election.

The transferee must claim the credit in the taxable year of the Eligible Taxpayer in which the credit is determined or, if the transferee and the Eligible Taxpayer have different taxable years, in the following year. The transferee must include in its tax return (x) a completed IRS Form 3800, *General Business Credit*, (y) the completed and signed transfer election statement described below, and (z) any other information specified in guidance.

A transfer election statement must be completed by both the Eligible Taxpayer and the transferee, and must generally include (1) the name, address and taxpayer identification number of the Eligible Taxpayer and the transferee, (2) a statement that provides the necessary information and amounts to allow the transferee to account for the transferred tax credit, (3) a statement that the parties are not related, (4) a representation from the Eligible Taxpayer that it has complied with all relevant requirements to make a transfer election, (5) a statement from the Eligible Taxpayer and the transferee acknowledging the notification of recapture requirements (if applicable), and (6) a statement or representation from the Eligible Taxpayer that it has provided the required minimum documentation to the transferee (including documentation to validate the existence of the eligible credit property, any bonus credit amounts, and the evidence of credit qualification). The Eligible Taxpayer must sign the transfer election statement under penalties of perjury, the transfer election statement must include the transferee's written consent, and both the Eligible Taxpayer and the transferee must each attach the transfer election statement to their tax returns. If the amount of the transferred tax credit is determined to be excessive, the transferee will owe the federal government the excessive payment plus a 20% penalty thereon.

CHIPS Act Provisions

Although the tax credit for manufacturing semiconductors under Section 48D, enacted as part of the CHIPS Act, is separate from the IRA tax credits, Section 48D has its own direct pay provision that is broadly similar to the direct pay provision of Section 6417. The Proposed CHIPS Act Regulations include provisions relating to partnerships and S corporations that are generally similar to the corresponding provisions in the Proposed 6417 Regulations.

New Tax Credit Registration System

Under the Temporary Registration Portal Regulations, taxpayers that intend to make a direct pay election or a transfer election for a tax credit under the monetization provisions described above must register with the IRS on a new online portal before making the election.

In order to administer the direct pay and transfer provisions of the IRA and CHIPS Act, the IRS expects to create an online registration portal that will provide a special registration number to a taxpayer that intends to elect direct pay or transfer a tax credit. Taxpayers will be required to obtain this registration number as a condition to monetizing a tax credit and before making the relevant election. A taxpayer must obtain a separate registration number for each project for which the taxpayer intends to monetize a tax credit. The IRS will review the information that a taxpayer provides through the portal and will issue a registration number based on whether the taxpayer has provided sufficient verifiable information. The registration number must be included on the tax return for the year for which the taxpayer is making the election.

In the case of a transfer of tax credits, the transferee's tax return will also have to include the registration number obtained by the transferor. Applicable Entities, Electing Taxpayers, Eligible Taxpayers, and transferees of a tax credit should be aware that issuance of a registration number does not mean the IRS has determined that the Eligible Taxpayer is entitled to transfer the tax credit or that the Applicable Entity, Electing Taxpayer, Eligible Taxpayer, or transferee, as applicable, is entitled to claim the transferred credit.

The registration number is only good for one year. A registration number must be renewed if a direct pay or transfer election is to be made for any year after the year in which the registration number was obtained, which requires the registrant to attest that all information previously provided is still correct or update any information that is relevant in calculating the amount of the tax credit. In addition, if certain events occur (such as a change in control of a registrant) the registration may need to be amended or a new registration number may need to be obtained.

To obtain a registration number, a taxpayer will need to provide (i) general information, such as the taxpayer's name, address, taxpayer identification number, type of entity, and information about the taxpayer's tax-exempt status, if applicable, (ii) any additional information required by the portal, (iii) the taxpayer's taxable year, (iv) the type of annual tax returns normally filed by the taxpayer, if any, (v) the type of tax credit that the taxpayer intends to monetize, (vi) a list of the projects for which the taxpayer intends to elect direct payment of or to transfer a tax credit, and (vii) a contact person for the taxpayer. For each project, the taxpayer will have to provide further information required by the portal, as applicable, such as (A) the type of project, (B) the physical location of the project, (C) supporting documentation relating to the construction, reconstruction or acquisition of the project, (D) the beginning of construction and placed in service dates, (E) the source of funds used by the taxpayer to acquire the project, and (F) any other information that the taxpayer believes will be helpful for the IRS. The taxpayer will need to sign a penalties of perjury statement when requesting a registration number through the portal.

Conclusion

This package of proposed and temporary regulations answers many of the most pressing questions being raised by practitioners about the new tax credit monetization provisions in the IRA and the CHIPS Act. The regulations include a few surprises, but the IRS's approach is generally practical and reasonably taxpayer-favorable. Chapman will continue to monitor and provide updates on this quickly developing area of tax law.

For More Information

If you would like further information concerning the matters discussed in this article, please contact the following attorneys or the Chapman attorney with whom you regularly work:

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- 1 References to "Sections" in this Client Alert refer to sections of the Internal Revenue Code of 1986 (the "Code").
 - 2 Section 6417 permits direct pay elections for twelve tax credits:
 - Section 48 – Investment Tax Credit for Energy Property
 - Section 45 – Renewable Electricity Production Tax Credit
 - Section 48E – Clean Electricity Investment Credit
 - Section 45Y – Clean Electricity Production Tax Credit
 - Section 45W – Credit for Qualified Commercial Clean Vehicles (limited to certain entities)
 - Section 30C – Alternative Fuel Vehicle Refueling Property Credit
 - Section 48C – Advanced Energy Project Credit
 - Section 45X – Advanced Manufacturing Production Credit
 - Section 45Z – Clean Fuel Production Credit
 - Section 45Q – Credit for Carbon Oxide Sequestration
 - Section 45U – Zero-Emission Nuclear Power Production Credit
 - Section 45V – Clean Hydrogen Production Tax Credit
 - 3 The list of tax credits that can be transferred under Section 6418 is the same as the list under Section 6417, except that the tax credit for Qualified Commercial Clean Vehicles under Section 45W cannot be transferred.

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