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IRS Issues Final Regulations on Transfer of Certain Tax Credits

On April 25, 2024, the Treasury Department issued final regulations pursuant to Internal Revenue Code Section 6418, replacing the Proposed and Temporary Regulations issued on June 14, 2023. Overall, the final regulations mostly rejected calls by the tax credit industry to ease certain restrictions on transfer to broaden the pool of potential transferees, instead largely maintaining the rules adopted under the proposed regulations while clarifying several key points. Key takeaways from the final regulations include:

- Clarifying that a transferee partnership whose partners include one or more “applicable entities” pursuant to Code Section 6417(d)(1)(A) (tax-exempt organizations, state or political subdivisions, the Tennessee Valley Authority, an Indian tribal government, an Alaska native corporation, or any corporation operating on a cooperative basis) may constitute an eligible taxpayer which may make a transfer election pursuant to Code Section 6418. The final regulations note, however, that the amount of credits eligible for transfer may be reduced or limited as a result of the tax-exempt use property limitations. Since there was no further easing of this limitation, transferor partnerships with tax-exempt partners may end up with a sizable “haircut” on the amount of credits available for transfer. However, the final regulations do not limit an exempt partner’s ability to form a blocker corporation and to make an election pursuant to Code Section 168(h) to treat income received from the partnership as taxable income, thus avoiding having to reduce the amount of credits available for transfer.
- Denying a request to include an exception to allow advanced payments in certain limited situations, but noting that the rules do not prohibit a tax credit purchaser from loaning money to a project. Such loans may be secured by the tax credit purchase and sale agreement, provided the loans are at arm’s length and satisfy the requirements necessary in order to be treated as debt for federal income tax purposes. Treasury notes, however, that whether such loan should be recharacterized as an upfront payment for transferred credits or otherwise recharacterized is dependent upon the applicable facts and circumstances and not addressed in the regulations. The industry was hoping that the Treasury Department would reconsider this rule and allow such advance payments particularly in the context of forward contracts for the transfer of streams of production tax credits in excess of one year.

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- The final regulations grant taxpayers an automatic six-month extension to file a transfer election statement pursuant to Treasury Regulations Section 301.9100-2(c), but only to the extent that the date for filing the original return has not already been extended, the return was timely filed, and only to the extent the request satisfies the procedural requirements set forth in Treasury Regulation Section 301.9100-2(d). As a result, the window to transfer credits will generally always end with the due date of the transferor's tax return on extension.
- The final regulations revise examples addressing the application of anti-abuse rules by removing language referring to the "average transfer price of the eligible credit between related parties" to "an arm's length price of the eligible credit without regard to other commercial relationships." This change should remove uncertainty by recognizing a potential lack of market data for certain types of credits and by acknowledging that pricing data may be dependent upon the specific facts and circumstances of the transaction (including risk profile of the particular technology, sponsor and guarantor strength and experience, recapture risk, availability of tax credit insurance, etc.).
- In an effort to broaden the pool of potential transferees beyond corporate buyers, several comments to the proposed regulations submitted to the Treasury Department requested that individual taxpayers be allowed to take advantage of transferrable credits pursuant to Code Section 6418. In issuing the final regulations, the Treasury Department reaffirmed that the passive loss rules set forth in Code Section 469 (which typically limits an individual taxpayer's ability to utilize Code Section 38 general business credits) apply in the case of a transfer election pursuant to Code Section 6418 and declined to include a carveout for individual taxpayers seeking to utilize transferrable credits. Notably, the IRS declined to extend the application of Rev. Rul. 2016-16, 2010-26 I.R.B. 769 to transactions involving the transfer of eligible credits pursuant to Code Section 6418 because unlike the Code Section 45D credit, each of the eligible credits listed in Code Section 6418 can only be generated through the conduct of a trade or business by the transferee, not the investment activity of the transferee, and therefore cannot be redetermined in connection with the transferee's investment activity.
- In an effort to provide greater flexibility in apportioning risk associated with certain bonus adders, several commenters requested that the Treasury Department reverse the rule contained in the proposed regulations prohibiting tax credit sellers from making an election with respect to just the portion of credits attributable to such bonus adders. However, the Treasury Department noted that bonus credits are not themselves eligible credits, and further reasoned that severing the bonus credit from the base credit amount would create additional administrative burdens, therefore rejecting these requests.

Overall, the final regulations did not differ dramatically in substance in comparison to the proposed transactions but should provide additional clarity in answering most lingering questions after the initial release of the proposed regulations.