CLIENT ALERT

Final Regulations Issued on Tax Credit Transfers

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Newly-issued final regulations applicable to tax credit transfers largely adopt the proposed regulations that were issued in June 2023. The final regulations are available here. Taxpayers are permitted to transfer certain tax credits pursuant to Code Section 6418, as enacted by the Inflation Reduction Act of 2022. Eligible tax credits include the investment tax credit (ITC) and the production tax credit (PTC). An eligible taxpayer may elect to transfer all (or a portion specified in the election) of eligible credits to an unrelated taxpayer solely in exchange for cash.

We continue to review the final regulations. Below is a brief summary of a few notable items.

<u>Application of “Paid in Cash” Requirement to Advance Payments</u>

Commenters requested that the final regulations allow advanced payments for transfers of eligible credits that will be determined in later taxable years. Such a change would have aligned the timing of payments for PTCs with the timing of payments for ITCs and would have more closely aligned transferability with traditional tax equity structures. PTCs are claimed based on annual production over a ten-year period after a project is placed in service. ITCs are claimed in the year that the project is placed in service. However, Treasury rejected such request and adopted the “paid in cash” definition of the proposed regulations that does not allow advanced payments.

<u>Transfers of a “Horizontal Slice”</u>

The proposed regulations prohibited horizontal credit transfers (a transfer of only a bonus credit or only a base credit, for example) and instead required vertical credit transfers (a transfer of the entire eligible credit or a portion of the entire eligible credit which would include a proportionate amount of any bonus credit amounts). Several commenters recommended that the final regulations allow for horizontal credit transfers. Due to the need for taxpayers and the IRS to track all base and bonus credit amounts separately and the administrative issues that would be involved, the final regulations rejected this request. The final regulations also noted that a bonus credit amount is not itself an eligible credit but only an amount taken into account to determine the single eligible credit with respect to an eligible credit property.

Passive Credit Rules

Final regulations rejected comments requesting that the regulations not treat a purchased tax credit as being subject to the passive loss rules. The passive loss rules limit the ability of individuals, trusts and closely-held corporations to participate in the transfer and tax equity markets.

Registration

While numerous comments were received on the IRS registration process, most were rejected and the Treasury noted that the IRS will consider ways outside of the final regulations to make the pre-filing registration process more streamlined for eligible taxpayers.

Recapture

The final regulations adopt the rule that recapture tax liability is not treated in the same manner as an excessive credit transfer tax liability and, therefore, the transferee taxpayer bears a proportionate share of recapture, without looking to the transferor first. This rule is not applicable to dispositions by a partner of an interest in a transferor partnership as that recapture liability remains with such partner. However, the final regulations clarify that to the extent a partner in a partnership recognizes recapture that does not result in recapture liability to a transferee taxpayer, that amount reduces the remaining amount of ITCs subject to recapture for a recapture event caused directly by the transferor partnership. The proportionate share rule for recapture differs from disallowances of tax credits (e.g., an ITC basis reduction, a reduction in the credit due to failing to qualify for the 5x multiplier). In the case of a disallowance, the IRS will first disallow credits retained by the transferor before disallowing any credits transferred to a transferee.

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