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IRS Issues Final Regulations on Tax Credit Transfers

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On April 25, the Treasury Department (Treasury) and the Internal Revenue Service (IRS) issued [final regulations](#) (Final Regulations) on tax credit transfers pursuant to Section 6418 of the Internal Revenue Code of 1986, as amended (Code), which was enacted by the [Inflation Reduction Act](#). Section 6418 allows eligible taxpayers to elect to transfer certain tax credits, including the Investment Tax Credit (ITC) and the renewable electricity production tax credit (PTC), to unrelated taxpayers rather than using the credits against their federal income tax liabilities.

The Final Regulations will become effective 60 days after their publication in the *Federal Register* (currently scheduled for April 30) and will apply to taxable years ending on or after this date. Taxpayers may choose to apply the rules of Treasury Regulation Sections 1.6418-1 through 1.6418-3 and 1.6418-5 for taxable years ending before that date, provided they apply the rules in their entirety and in a consistent manner.

Analysis

The Final Regulations are generally consistent with the proposed regulations and temporary regulations released by Treasury and IRS on June 14, 2023, which we addressed in our [prior alert](#). The Final Regulations address several items of interest to eligible taxpayers, including:

- Partnerships with applicable entities as owners;
- Relief (or the lack thereof) for late elections;
- The “determined with respect to” requirement;
- Limitations after a transfer is made; and
- Procedural details about the pre-filing registration process.

These items are discussed below, together with other noteworthy aspects of the Final Regulations.

- *Partnerships.* Treasury and the IRS confirmed that, if a partnership has not elected direct pay for credits pursuant to Sections 45V, 45Q, or 45X, it may qualify as an eligible taxpayer for purposes of a tax credit transfer. However, the Preamble clarifies that Section 50(b)(3) and (4) may limit the ITCs determined with

respect to any tax-exempt or government entity partner.

- *Section 45Q Eligible Credit Property.* Commenters recommended revising the definition of eligible credit property for purposes of Section 45Q to reconcile with Rev. Rul. 2021-13, 2021-30 I.R.B. 152, under which a taxpayer needs to own only one component in a single process train to be the person to whom the Section 45Q credit is attributable (provided the taxpayer also meets the requirements of Section 45Q(a), as applicable). The Final Regulations adopt this recommendation and define eligible credit property with respect to Section 45Q as a component of carbon capture equipment within a single process train described in Treasury Regulation Section 1.45Q-2(c)(3).
- *Paid in Cash Definition and Loans.* Commenters had requested that the final regulations permit upfront payments for transfers of PTCs that will be determined in future taxable years. The Preamble notes that, although permitting such advance payments may more closely align Section 6418 tax credit transfer transactions with tax equity transactions, allowing advance payments would create complex legal and administrative issues, such as whether an excessive credit transfer has occurred if prepaid eligible credits were not transferred in a later tax year. As a result, the Final Regulations adopt the “paid in cash” definition of the proposed regulations without change.
 - The Preamble also notes that there is no prohibition on either a transferee taxpayer or another third party loaning funds to an eligible taxpayer. The Preamble rather unhelpfully notes that the treatment of such loans as upfront payments for eligible credits or their recharacterization, is subject to a facts and circumstances analysis of the loan.
- *Specified Credit Portion.* The Final Regulations adopt the definition of specified credit portion from the proposed regulations, pursuant to which an eligible taxpayer cannot separately transfer the bonus credit amount from the base eligible credit amount (a horizontal credit transfer). Rather, an eligible taxpayer is allowed to transfer the entire eligible credit, or a portion of the entire eligible credit, determined with respect to a single eligible credit property (a vertical credit transfer). Commenters recommended allowing horizontal credit transfers, but Treasury and the IRS were not persuaded.
- *Grantor Trusts.* The Final Regulations provide that if an eligible taxpayer is a grantor or is otherwise treated as the owner of any portion of a trust as described in Section 671, the eligible taxpayer may make a transfer election for any eligible credits determined with respect to eligible credit property held directly by the portion of the trust that the eligible taxpayer is treated as owning.
- *“Determined With Respect to” Requirement.* The Final Regulations follow the proposed regulations under both Section 6417 and 6418 (the tax credit transfer provision) in requiring that a transfer election can be made only with respect to a credit that has been “determined with respect to” the applicable entity or electing taxpayer, meaning that the applicable entity or electing taxpayer must own the underlying eligible credit property or, in the case of Section 45X, conduct the activities giving rise to the underlying eligible credit. This rule prohibits transfer elections for credits transferred pursuant to Section 45Q(f)(3), acquired by a lessee from a lessor pursuant to a “lease pass-through” election, owned by a third party, or otherwise not determined directly with respect to the applicable entity or electing taxpayer (chaining). The Preamble clarified that the owner-lessor in a sale-leaseback can make a transfer election.

- *Amended Returns.* Multiple commenters asked that a transfer election be permitted on an amended return or that a taxpayer be permitted an extension of time under certain relief procedures to make a late election. The Final Regulations did not adopt the broad relief requested, offering only a clarification intended to address situations in which a taxpayer intended to make a transfer election but made a reporting error with respect to an element of a valid election. Unfortunately, this provision cannot be used to revoke an election or to make an election for the first time on an amended return. However, the Preamble did clarify that a superseding return (a return filed after an originally filed return but before the due date for filing the return with extensions) could be filed to increase or decrease the amount of the eligible credit if the amount of the eligible credit was incorrectly reported on the original return. The Preamble further clarifies that an adjustment to the eligible credit may impact the tax liability of the transferee taxpayer.
 - The absence of late election relief for the transfer election underscores the absolute necessity of monitoring the filing process for tax returns where transfer elections will be made.
- *Required Minimum Documentation.* Several commenters recommended that the final regulations increase the amount of required minimum documentation that an eligible taxpayer must provide to a transferee taxpayer. Treasury and the IRS declined to follow the recommendation, stating that “the intention was to require a baseline of information that is necessary for validating an eligible taxpayer’s claim of eligibility to an eligible credit, while not overburdening the eligible taxpayer with production requirements or altering the arm’s length arrangement between the parties.” The Preamble also clarifies that the responsibility for substantiating an increased credit amount pursuant to the prevailing wage and apprenticeship requirements remains with the eligible taxpayer and does not shift to the transferee taxpayer, despite the transferee taxpayer’s treatment as the relevant taxpayer for other purposes under the IRA.
 - Although the scope of what constitutes “required minimum documentation” is not entirely clear, the statement helpfully indicates that the intent is not to require exhaustive documentation concerning eligibility.
- *Multiple Transfers.* Consistent with Section 6418(e)(2), the proposed regulations would have prohibited a transferee taxpayer of any specified credit portion from making a second transfer of such transferred credit. The problem with applying this rule, as commenters noted, was that it would have been unworkable to apply the typical “benefits and burdens” to determine who owns a tax credit (and accordingly, whether a tax credit has been transferred). Treasury and the IRS clarify that the requirements of Treasury Regulation Section 1.6418-2(b), including the filing of the tax return, must be satisfied for a transfer to occur.
 - The Preamble indicates that an assignment of interests in tax credit transfer agreements is “a transaction that is outside of [S]ection 6418” — e., does not constitute a transfer of credits.
- *Territories.* Section 50(b)(1) provides that property used outside the U.S. is not eligible for the ITC. Treasury and the IRS declined to follow the recommendation of commenters that there be an exception to the general rule in Section 50(b)(1) for territorial applicable entities making elections under Section 6418 for investment tax credits.
- *Anti-Abuse Rule.* The Final Regulations clarify the anti-abuse rule.
 - “*A Principal Purpose*” Standard. The Final Regulations clarify the anti-abuse rule by providing that the anti-

abuse provision applies if a transaction is entered into with a principal purpose of avoidance of tax beyond the intent of Section 6418, rather than the principal purpose of such avoidance.

- *Recharacterization.* The Final Regulations address the determination of whether transactions are subject to recharacterization under the proposed anti-abuse rule by comparing the price paid in the subject transaction to an arm's length price of the eligible credit. This varies from the proposed regulations, which would have referred to the average transfer price of the eligible credit to determine whether a transaction was subject to recharacterization. This approach reflects the intent of the anti-abuse rule by allowing recharacterization if the price paid is unreasonable based on the facts and circumstances of the transaction.
- *Taxable Year.* Several comments requested clarification relating to transferee taxable years in connection with the determination of when the transferee taxpayer may take the specified credit portion into account. The Final Regulations clarify that a 52-53 week taxable year is deemed to end on the last day of the calendar month nearest to the last day of the 52-53 week taxable year.
- *Passive Credit Rules.* The Final Regulations follow the proposed regulations in applying the passive credit rules to purchased credits. They also adopt certain clarifying provisions.
- *Estimated Tax Payments.* Treasury and the IRS declined to include a specific rule regarding a transferee taxpayer's calculation of estimated tax payments based on a specified credit portion that the transferee taxpayer has purchased or intends to purchase. However, the Preamble clarifies that, because a tax credit transfer contemplates a transferee taxpayer stepping into the shoes of the eligible taxpayer, it follows that a transferee taxpayer may take into account the eligible credit in calculating its estimated tax liability no earlier than an eligible taxpayer would. Commenters requested clarification regarding the "intends to purchase" phrase from the proposed regulations in this context. The Preamble further clarifies that (i) the phrase refers to a situation in which the taxpayer plans to complete a transaction that would qualify the taxpayer as a transferee taxpayer and (ii) the phrase demonstrates that all of the requirements for a tax credit transfer under the Final Regulations do not have to be satisfied for a transferee taxpayer to incorporate the eligible credit in its estimated tax calculations.
- *Partnership Allocations.* The Final Regulations are largely consistent with the proposed regulations with respect to partnership allocation matters. The Preamble suggests that "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 to such partner, such amounts can be made or revised under [S]ection 761(c) up until the due date (not including extensions) of the partnership's annual tax return."
- *Pre-filing Registration.* The Preamble addresses several issues concerning the pre-filing registration process.
 - *Process.* Commenters requested a streamlined process for registration, such as registration for multiple properties, or alternatives to the registration process, such as an election out of pre-filing registration. The Preamble states that the IRS will consider requests for a more streamlined pre-filing registration process. However, the Final Regulations adopt a registration process that is consistent with the proposed regulations for now. The Preamble also rejects the suggestion to allow transfers without a pre-filing registration, citing the importance of pre-filing registrations in ensuring the quality and accuracy of information provided.

- *Timing.* Commenters were concerned about the timeliness of registration approval, and offered suggestions, including suggestions that the IRS provide time estimates for issuing registration numbers or be required to provide reasons for a delay in issuing a registration number. The Final Regulations provided no relief on this topic, and the Preamble directs taxpayers with timing questions to Publication 5884.
- *Denial.* Consistent with the approach adopted in the Section 6417 “direct pay” final regulations, the Preamble clarified that appeal rights for a denial of a registration are severely limited, stating: “once the IRS determines that a registration number should not be given, the registrant cannot appeal the denial unless the IRS and Appeals agree that such review is available and the IRS provides the time and manner for such review.”
- *Grouping.* Also consistent with the approach of the direct pay final regulations, the Final Regulations rejected the request of multiple commenters that taxpayers be able to group multiple qualified facilities as a “single project” that would obtain a single registration number, or that consolidated filings be available for multiple facilities (e.g., multiturbine wind farms). However, the Final Regulations reiterate that applicable credit property information can be uploaded by way of a spreadsheet file (bulk upload).
 - This approach seems unnecessarily difficult, creating administrative burdens for both the IRS and taxpayers. The Preamble does a poor job of justifying the position of Treasury and the IRS.
- *Yearly Registration.* Treasury and the IRS rejected requests for exceptions to the yearly registration requirement. The Preamble cites administrative needs of the IRS in tracking the eligible credit property and the transferred specific credit portion in rejecting these requests.
- *Documentation.* The Preamble clarifies that an applicable entity may use a certificate, permit, or evidence of ownership, rather than all three, during pre-filing registration. The Final Regulations adopt the approach of the proposed regulations with respect to the amount of required minimum documentation an eligible taxpayer must provide to a transferee taxpayer.
- *Authorized Representative.* The Preamble clarifies that an authorized representative may apply for a registration number on behalf of the taxpayer.
- *Excessive Payments.* The Preamble and the Final Regulations address several important points relating to excessive credit transfers.
 - The Final Regulations do not adopt any variation from established examination procedures for excessive credit transfer determinations. The Preamble clarifies that an eligible taxpayer or transferee taxpayer may challenge an adverse determination with respect to an excess credit transfer determination if the determination creates a tax deficiency in accordance with established deficiency procedures.
 - To clarify the tax consequences to a transferee taxpayer with respect to payments made to an eligible taxpayer that directly relate to an excessive credit transfer, the Final Regulations provide that any payment made by a transferee taxpayer that directly relates to the excessive credit transfer is not subject to Section 6418(b)(2) and the transferee taxpayer is not precluded from deducting the portion of the consideration paid to the eligible taxpayer for a specified credit portion that relates to an excessive credit transfer.

- Under Section 6418, if a transferee taxpayer demonstrates that an excessive credit transfer resulted from reasonable cause, the excessive credit transfer addition to tax will not apply. The Preamble clarifies that the most important factor in the facts-and-circumstances determination of reasonable cause is the extent of the transferee taxpayer’s efforts to determine that the amount of specified credit portion transferred by the eligible taxpayer to the transferee taxpayer is not an excessive credit transfer. The Preamble further clarifies that relying solely on an eligible taxpayer’s representations does not align with a transferee taxpayer’s efforts that are sufficient to support a reasonable cause defense.
- Treasury and the IRS rejected a suggestion to allow an eligible taxpayer to determine the order of eligible credits transferred for determining an excessive credit transfer if there are multiple transferees. The Preamble states that the definition of an excessive credit transfer effectively includes an ordering rule, but adding an ordering election would add administrative complexity.
- Treasury and the IRS also rejected suggestions to include an election not to apply the excessive credit transfer rules in specified circumstances. The Preamble notes that such a rule would not align with the definition of an excessive credit transfer.

- *Recapture.* The Final Regulations address several issues relating to recapture.
 - The Preamble states that Treasury and the IRS have determined that the risk of recapture should be borne by the transferee taxpayer with respect to its specified credit portion for all types of recapture events directly relating to an eligible taxpayer (other than recapture events involving transfers of interests by partners in a transferor partnership or S corporation).
 - The Final Regulations clarify that, except in the case of a partner or S corporation shareholder that has disposed of an interest in a transferor partnership or transferor S corporation and is subject to the rules relating to such disposition under the applicable regulations, recapture liability applies proportionately to any transferee taxpayer and an eligible taxpayer to the extent an eligible taxpayer has retained eligible credits determined with respect to the relevant eligible credit property.
 - The Final Regulations also clarify the impact of a partner or S corporation shareholder recapture event on the remaining amount of recapture liability for which the transferee taxpayer and the transferor partnership or transferor S corporation is responsible, and provide examples to illustrate the party responsible for recapture in the context of a sale of a portion of an interest in a transferor partnership and a subsequent sale of the investment credit property by the transferor partnership.
 - In response to requests to mitigate instances of duplicate recapture of the same ITC, the Final Regulations clarify that, to the extent a partner in a transferor partnership or a shareholder in a transferor S corporation recognizes an amount of tax increase that does not result in recapture liability to a transferee taxpayer under the applicable Final Regulation, that amount reduces the remaining amount of ITC subject to recapture for a recapture event caused directly by the transferor partnership or transferee S corporation.
- *Normalization Rules.* Commenters requested guidance on the application of normalization rules under Section 50(d)(2) to applicable tax credit transfers. While Treasury and the IRS declined to adopt a rule addressing the

normalization rules, the Preamble clarifies that an eligible taxpayer is not subject to the normalization rules for any cash consideration paid by a transferee taxpayer for a specified credit portion.

Conclusion

The Final Regulations closely follow the proposed regulations and align with the direct pay final regulations on several points. Taxpayers hoping for a dramatic change in direction on particular issues will largely be disappointed. The lack of change in the Final Regulations continues the trend of recent final IRA guidance that barely departs from proposed guidance, indicating that the rapid release of final IRA guidance is a high priority for Treasury. Interestingly, much like the preamble to the direct pay final regulations, the Preamble meticulously addresses comments within the scope of the Final Regulations and dismisses comments outside the scope. Undoubtedly, this is to position the Final Regulations to withstand political, or potentially legal, challenges going forward. However, the mere issuance of the Final Regulations should further energize the tax credit transfer market, which is already developing at a rapid pace.

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