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Treasury Provides Key Guidance for Monetizing Clean Energy Tax Credits

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June 20, 2023

The Treasury Department (Treasury) and the Internal Revenue Service (IRS) issued guidance on June 14, 2023, regarding the Inflation Reduction Act's (IRA) two new clean energy tax credit delivery mechanisms – one on elective pay (otherwise known as "direct pay") and one on transferability.

The guidance is highly complex and advanced tax planning is advisable. Should you have questions, please contact a member of our Tax team with questions about this new guidance.

Initial Insights:

Prior to the IRA, government entities, many types of tax-exempt organizations, and start-up businesses could not fully benefit from clean energy tax credits because they did not have any or enough tax liability. The IRA's elective pay and transferability options allow these entities to either get a check from the Treasury for the tax credit amount or transfer (sell) their tax credits for cash. The transferability option is intended to expand the practice of selling tax credits beyond typical players in tax equity deals.

Importantly, this notice provides regulatory clarity for state, local, and Tribal governments, non-profit organizations, and U.S. territories to take advantage of the IRA's clean energy tax credits. Treasury has provided an expansive definition of agencies and instrumentalities of states or political subdivisions that qualify for elective pay, including "water districts, school districts, economic development agencies, and public universities and hospitals."

Additionally, as highlighted below, Treasury has provided elective pay instructions for solar, wind, battery, inverter, and critical mineral manufacturers to access the Internal Revenue Code Section 45X advanced manufacturing tax credit; for hydrogen producers to access the Section 45V clean hydrogen production credit; and for energy developers to access the Section 45Q carbon capture and sequestration credit. This guidance will provide projects with the legal clarity needed to advance financing deals.

Overview of Elective Pay: Elective pay allows applicable entities to claim certain IRA tax credits without having to owe federal income tax. For example, a local government that builds a solar array and qualifies for the production tax credit can file an annual tax return with the IRS to claim an elective payment for this credit. The IRS would then make a refund payment in the amount of the credit to the local government.

Overview of Transferability: Transferability allows an entity that claims certain IRA tax credits to elect to transfer (sell) all, or a portion of the tax credits to an unrelated third-party transferee (buyer) in exchange for cash

IRA Credits for Elective Pay:

The guidance affects elective pay for tax-exempt organizations including state and local governments, Tribal governments, Alaska Native Corporations, the Tennessee Valley Authority, instrumentalities of the state, and rural electric cooperatives for the following credits:

- Section 48 ITC

- Section 45 PTC
- Section 30C alternative fuel vehicle refueling property credit
- Section 48C advanced energy project credit
- Section 45U zero-emission nuclear power production credit
- Section 45W commercial clean vehicle credit
- Section 45Y clean electricity production credit
- Section 48E clean electricity investment credit
- Section 45Z clean fuel production credit

Private and the tax-exempt entities listed above can access elective pay for the following credits, which are among the largest in the IRA:

- Section 45V clean hydrogen production credit
- Section 45X advanced manufacturing production credit
- Section 45Q credit for carbon capture and sequestration

IRA Credits for Transferability:

Private and tax-exempt entities can access the transferability option for the following credits:

- Section 30C alternative fuel refueling property credit
- Section 45 renewable electricity production credit
- Section 45Q credit for carbon oxide sequestration
- Section 45U zero-emission nuclear power credit
- Section 45V clean hydrogen production credit
- Section 45X advanced manufacturing production credit
- Section 45Y clean electricity production credit
- Section 45Z clean fuel production credit
- Section 48 energy investment tax credit
- Section 48C advanced energy project credit
- Section 48E clean electricity investment credit

The White House has provided the following instructions for entities wishing to claim direct pay:

Step 1: Identify the project and the credit you want to pursue.

Step 2: Complete your project, place it into service, and determine the corresponding tax year.

- *You can only use direct pay after you earn the tax credit. For Investment Tax Credits, you earn the credit during the tax year that your clean energy project is placed in service. In many cases, the tax year corresponds to the calendar year – so if your project is coming online in 2023, your tax year is also often 2023. More information on determining your tax year is available here.*

Step 3: Determine when your tax return will be due.

- *For most tax-exempt and governmental entities, the return for a taxable year is due 4.5 months after the end of that taxable year. For example, if your tax year is the calendar year, and your project is coming online in 2023, your tax return will be due by May 15, 2024. Those without a filing requirement can also receive an automatic six-month extension.*

Step 4: Complete pre-filing registration with the IRS before your tax return is due.

- *More information about pre-filing registration will be available by late 2023. You'll need to register with the IRS and receive a registration number before you can file a tax return and receive payment. In general, each registration number corresponds to one clean energy property in one tax year – you will need to renew the number if you need to use it in other tax years. During the pre-registration process, you will need to provide information about your organization, the credits you want to earn, and your eligible clean energy project in an online portal.*

Step 5: Once you receive a valid registration number, file your tax return by the due date, including extensions.

- *You'll need to provide your registration number and make the elective payment selection on your tax return (typically a Form 990-T for most entities that don't normally file a tax return). You also need to provide additional required documentation and underlying credit forms when you file your return. You can find more filing tips for tax-exempt organizations here.*

Step 6: Receive your direct payment.

- *In general, payments occur after your return is successfully processed.*

For manufacturers seeking Elective Pay for the Section 45X advanced manufacturing production credit: Any elective payment election, with respect to a Section 45X credit, applies separately with respect to each facility, at which a taxpayer produces (after December 31, 2022) eligible components (can be found here). The electing taxpayer is treated as having made such election for the taxable year, with respect to which the election is made and each of the four subsequent taxable years ending before January 1, 2033. This election cannot be revoked, and a transfer election cannot be made after such an election.

For those seeking Elective Pay after 2024: Starting in 2024, for entities using elective pay, the domestic content requirement, if not met, can result in a reduction of the applicable credit amount for Sections 45, 45Y, 48, and 48E. The IRS plans to issue future guidance on this issue. More on the domestic content rules can be found here.

Treasury, working with interagency partners, will also be conducting outreach to educate stakeholders through speaking engagements, webinars, and similar engagements in the coming months. This will include a series of webinars this summer, beginning Thursday, June 29, where interested stakeholders can learn more. In addition, IRS.gov contains more information regarding the proposed and temporary guidance, as well as the underlying tax credits that can be used with elective pay and transferability.

Rulemaking Process to Follow:

Treasury will use the guidance to issue proposed regulations on June 21. Should you have questions, please contact a member of our Tax team if you are interested in commenting on the guidance. Written or electronic comments must be received by August 14, 2023.