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Regulatory Update

IRS and Treasury Release Proposed Regulations on Section 45Z Clean Fuel Production Credit

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On Feb. 3, the U.S. Treasury Department (Treasury) and the Internal Revenue Service (IRS) issued the much-anticipated Proposed Regulations (Proposed Regulations) for the Clean Fuel Production Tax Credit under Section 45Z (45Z Credit) of the U.S. Internal Revenue Code of 1986, as amended (Code). The Proposed Regulations refine and clarify earlier draft guidance that was included in IRS Notice 2025-10 (released January 2025), addressing key issues raised by industry stakeholders.

The Proposed Regulations also introduce two explicit safe harbors that were not included in IRS Notice 2025-10, intended to provide greater certainty around substantiation of lifecycle greenhouse gas (GHG) emissions rates and qualification of sales for purposes of Section 45Z. Taxpayers may rely on these Proposed Regulations until final regulations are published in the Federal Register, provided taxpayers follow them in their entirety and in a consistent manner.

Key changes in the Proposed Regulations are outlined below.

Key Changes

Expanded Definition of 'Qualified Sales'

One of the most significant changes in the Proposed Regulations is a broader interpretation of what constitutes a qualified sale of fuel for purposes of the 45Z Credit. Under the statute, a "qualified sale" generally means a sale of clean fuel by the producer to an unrelated person for certain end uses (for use in a fuel mixture, for use in the buyer's trade or business or for retail sale into another's fuel tank). The initial draft regulations in Notice 2025-10 took a narrow view, specifying that a sale "for use in a trade or business" must be "for use as a fuel in the trade or business." This definition effectively excluded sales to intermediaries (such as wholesalers or traders) who resell the fuel in bulk, since those buyers are not themselves using the fuel in their operations. Notice 2025-10 indicated that a resale of fuel in bulk would not count as a qualified sale, and it also excluded sales of fuel used as a feedstock to produce another fuel (e.g., ethanol sold to make sustainable aviation fuel (SAF)).

In response to widespread concern from the biofuels industry, the Proposed Regulations reverse this restrictive stance on bulk resales of fuel. Sales to third-party distributors, marketers or other resellers will now qualify for the credit if the fuel is ultimately used in a manner described in Section 45Z. Treasury officials have confirmed that a producer can claim the 45Z Credit for fuel sold to an intermediary, clarifying that sales need not be directly to end-use consumers. This change aligns the rules with common industry

practices (in which producers often sell large volumes to wholesalers who then supply retailers or end users) and ensures producers are not penalized for using normal distribution channels.

The Proposed Regulations still retain the prohibition on “double counting” credits, effectively maintaining the restriction on sales of fuel used as a feedstock to produce another fuel. For example, if a producer sells ethanol to an unrelated party who uses it to manufacture SAF, the ethanol sale would not earn a 45Z Credit (since the SAF producer would claim the credit on the finished fuel). However, pure resale transactions (in which the fuel is not chemically transformed into a new fuel) are now clearly treated as qualified sales under the Proposed Regulations. This revision provides much-needed certainty that producers can utilize typical wholesale marketing arrangements without losing eligibility for the credit.

Safe Harbor for Substantiating Lifecycle Greenhouse Gas Emissions Rates

Under IRS Notice 2025-10, taxpayers were required to calculate lifecycle GHG emissions using the applicable Section 45Z GREET model and retain sufficient documentation to support all inputs and assumptions. While Notice 2025-10 referenced the use of default values, it did not provide a clear standard for when an emissions rate would be treated as adequately substantiated, leaving taxpayers exposed to potential challenges to model assumptions or methodologies. The Proposed Regulations address this uncertainty by establishing a safe harbor for substantiating emissions rates. Under this safe harbor, a taxpayer may rely on an emissions rate generated by the applicable Section 45Z GREET model if the taxpayer:

- Uses the most current Treasury-approved version of the Section 45Z GREET model for the taxable year.
- Inputs either default values provided by the model or taxpayer-specific values supported by contemporaneous books and records.
- Retains the model output and related documentation demonstrating how the emissions rate was determined.

If these requirements are satisfied, the emissions rate reflected in the model output is treated as substantiated for purposes of Section 45Z and a taxpayer relying on this safe harbor will not be required to independently validate the scientific assumptions underlying the GREET model.

Safe Harbor for Substantiating Qualified Sales

The Proposed Regulations also introduce a safe harbor for qualified sales, addressing concerns raised by the draft rules in Notice 2025-10 relating to sales through intermediaries and the producer's ability to verify downstream fuel use. Under the safe harbor a sale of fuel by a producer to an unrelated person is treated as a qualified sale if the producer obtains and retains a written certification from the purchaser stating that the fuel will be used in a manner described in Section 45Z, including resale for qualified fuel use. The producer must also retain standard transaction documentation for the sale. If these conditions are met, the producer is not required to trace the actual downstream use of the fuel or independently confirm the purchaser's representations. The Proposed Regulations expressly provide that reliance on the certification in good faith is sufficient, even if the fuel is later resold. Together with the emissions rate safe harbor described above, this qualified sales safe harbor reflects a shift away from the facts-and-circumstances framework reflected in Notice 2025-10 and provides a clearer compliance path for producers.

SAF

The Proposed Regulations provide additional clarity on the qualification of SAF under Section 45Z. As under the statute, SAF remains eligible for the 45Z Credit if it satisfies the applicable lifecycle GHG emissions reduction thresholds and other statutory requirements. The Proposed Regulations confirm that SAF is subject to the same general rules applicable to other transportation fuels, including the expanded definition of qualified sales and the safe harbors described above. The Proposed Regulations also reaffirm the prohibition on “double counting.” In other words, a sale of fuel as a feedstock to produce SAF will not constitute a qualified sale if the downstream producer claims the 45Z Credit on the finished SAF.

In addition, the Proposed Regulations clarify that a producer of SAF must satisfy the applicable certification requirements under Section 45Z, including any required documentation regarding lifecycle GHG and compliance with prevailing wage and apprenticeship requirements.

Provisional Emissions Rates

The Proposed Regulations also provide further guidance regarding the use of provisional emissions rates (PERs) to determine lifecycle GHG emissions under Section 45Z. If a fuel pathway does not have an established default emissions rate under the applicable Section 45Z GREET model, a taxpayer may determine its emissions rate using an approved modeling methodology consistent with Treasury guidance. A PER may not be used to calculate the 45Z Credit unless it has been approved by Treasury pursuant to the petition process described in the Proposed Regulations. The Proposed Regulations require submission of the technical modeling data and supporting documentation for Treasury review as part of that process.

Taxpayers relying on a PER must maintain contemporaneous books and records supporting the inputs and assumptions used in their modeling analysis. Under Notice 2025-10, taxpayers were permitted in certain circumstances to rely on a PER if a default pathway was not available under the GREET model. However, the procedures and substantiating requirements for obtaining or relying on a PER were not addressed.

New Feedstock Requirements and Emissions Methodology Updates

The Proposed Regulations also incorporate recent legislative changes enacted under the One Big Beautiful Bill Act (OBBBA) signed into law on July 4, 2025, which resulted in new requirements for feedstock sourcing and adjustments to emissions calculations. Notably, the OBBBA extended the availability of the 45Z Credit and imposed a domestic feedstock mandate. Effective 2026, only fuels produced from feedstocks originating in North America (the United States, Canada or Mexico) qualify for the 45Z Credit.

In addition, the methodology for calculating lifecycle GHG emissions has been updated to reflect the OBBBA. The OBBBA directed Treasury and other agencies to revise how certain emissions (like land-use changes) are accounted for, and the Proposed Regulations implement these updates. Notably, the treatment of land-use change emissions has been revised in a way that benefits crop-based biofuels. By adjusting the modeling assumptions, the “carbon intensity” of fuels made from corn, soy and similar feedstocks is effectively lowered, which in turn can yield larger tax credits per gallon (since the credit amount increases as lifecycle emissions decrease). This is a shift from the earlier draft guidance, which relied on the initial GREET model and default emissions factors.

Looking Ahead

The Proposed Regulations reaffirm and clarify many points from the initial guidance in Notice 2025-10, while providing a clearer path for taxpayers to utilize the credit. Taxpayers should be aware that the Proposed Regulations are not yet final. A 60-day public comment period will follow publication in the Federal Register, giving stakeholders an opportunity to provide feedback or request changes. The Treasury and IRS may further tweak the rules in response to comments before issuing final regulations.

In the meantime, companies in the biofuel and clean energy sectors should review the Proposed Regulations, especially the expanded qualified sale definition, feedstock requirements and safe harbors to understand how projects can qualify for the 45Z Credit and to ensure compliance with recordkeeping and registration obligations.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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