

June 2023

Follow @Paul\_Hastings



# Treasury and IRS Issue Long-Awaited Guidance on Energy Tax Credit Transfers

By [Michael D. Haun](#), [Kami LaBerge](#), [Lena Son](#), Kenneth Bagdasar & Nicole K. Wong

The Inflation Reduction Act of 2022 added Section 6418 to the Internal Revenue Code of 1986, as amended (the "Code"), which allows taxpayers to elect to transfer all or any portion of certain energy tax credits to an unrelated taxpayer in exchange for cash (such election, a "Transfer Election").

On June 14, 2023, the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") released a notice of proposed rulemaking and public hearing regarding the transfer of tax credits under Code Section 6418 (the "Proposed 6418 Regulations") and temporary regulations on pre-filing registration requirements (the "Pre-Filing Registration Requirements") for Transfer Elections (the "Temporary Regulations"). This long-awaited guidance is fairly comprehensive and provides taxpayers seeking to employ this new tax credit monetization option with clarity on numerous issues.

## I. Transfer of Certain Credits: Proposed 6418 Regulations

Code Section 6418 and the Proposed 6418 Regulations permit an "eligible taxpayer" (a "Transferor") to make a Transfer Election to sell any specified portion of an "eligible credit" determined with respect to any "eligible credit property" to an unrelated person (the "Transferee") in exchange for cash.

### A. Applicable Definitions

#### 1. Defining an "Eligible Taxpayer"

The Proposed 6418 Regulations clarify that any taxable entity is an "eligible taxpayer" for these purposes, regardless of whether that entity has a U.S. income tax obligation.

#### 2. Defining "Eligible Credits"

Transferors may make a Transfer Election for any of the following tax credits ("eligible credits"):

- Portion of the alternative fuel vehicle refueling property credit that is treated as a business credit (Section 30C);
- Renewable electricity production credit (Section 45) ("PTC");
- Energy investment tax credit (Section 48) ("ITC");
- Carbon oxide sequestration credit (Section 45Q);

- Zero-emissions nuclear power production credit (Section 45U);
- Clean hydrogen production credit (Section 45V);
- Advanced manufacturing production credit (Section 45X);
- Clean electricity production credit (Section 45Y);
- Clean fuel production credit determined (Section 45Z);
- Qualifying advanced energy project credit (Section 48C); and
- Clean energy investment credit (Section 48E).

Under the statute, the term “eligible credit” does not include any credit carryforwards or credit carrybacks. The Proposed 6418 Regulations reiterate this rule.

In addition, for the credits under Sections 45Q, 45V, or 45X, taxpayers may not make a Transfer Election for any taxable year for which a direct payment election under Code Section 6417 is in effect.

### 3. Defining “Eligible Credit Property”

Code Section 6418 and the Proposed 6418 Regulations require that the entire amount of an eligible credit be separately determined for each “eligible credit property” and include any bonus credit amount determined for that eligible credit property.

Under the Proposed 6418 Regulations, an “eligible credit property” is defined as the unit of property of a Transferor with respect to which the eligible credit is determined.

- For the alternative fuel vehicle refueling property credit (Section 30C), the ITC (Section 48), and the qualifying advanced energy project credit (Section 48C), taxpayers who wish to make a Transfer Election are required to register and make an election on a property-by-property basis.
- For the carbon oxide sequestration credit (Section 45Q), taxpayers who wish to make a Transfer Election are required to register and make an election for each unit of “carbon capture equipment” (as defined in the applicable Treasury Regulations).
- For all other eligible credits, taxpayers who wish to make a Transfer Election are required to register and make an election on a facility-by-facility basis.

With respect to the ITC, a Transferor will have the option to make the transfer registration and election for an “energy project” (i.e., a project consisting of one or more energy properties that are part of a single project). The preamble to the Proposed 6418 Regulations indicates that forthcoming guidance will further address this rule.

### 4. Determining a “Specified Credit Portion”

Consistent with the language in Code Section 6418(a) requiring the portion of the credit transferred to be specified, the Proposed 6418 Regulations provide that a “specified credit portion” of an eligible credit means a proportionate share (including all) of an entire eligible credit determined with respect to an eligible credit property of the Transferor that is specified in a Transfer Election. A specified credit portion

of an eligible credit must reflect a proportionate share of each bonus credit amount that is taken into account in calculating the entire amount of the eligible credit determined with respect to a single eligible credit property.

The Proposed 6418 Regulations do not permit a separate transfer of bonus credit amounts from the base credit amount determined with respect to an eligible credit property. Rather, the portion of the credit transferred must reflect a proportionate share of each bonus credit amount that is taken into account in calculating the entire amount of the credit for the property.

5. Payment of Consideration Must be in Cash

The statute requires that any consideration for a tax credit transfer be “paid in cash.” The Proposed 6418 Regulations clarify that “paid in cash” means a payment made in United States dollars by cash, check, cashier’s check, money order, wire transfer, ACH transfer or other bank transfer of immediately available funds. The cash payment must be made within the period beginning on the first day of the Transferor’s taxable year during which the specified credit portion is determined and ending on the due date for completing the transfer election statement (i.e., the earlier of the filing of the Transferor’s or the Transferee’s U.S. federal income tax return).

**B. Rules for Making Transfer Elections**

A Transfer Election must be made as provided in the Proposed 6418 Regulations, which provide the specific rules described below.

1. Multiple Transfer Elections Permitted

The Proposed 6418 Regulations provide that a Transferor may make multiple transfer elections to transfer one or more specified credit portions to multiple Transferees, provided that the aggregate amount of specified credit portions transferred with respect to a single eligible credit property does not exceed the amount of the eligible credit determined with respect to the eligible credit property.

2. Transfer Election in Certain Ownership Situations

The Proposed 6418 Regulations also enumerate rules on who may make the Transfer Elections in certain ownership situations:

- *Disregarded Entities.* A Transferor that wholly owns (directly or indirectly) a disregarded entity for income tax purposes that directly holds an eligible credit property may make a Transfer Election.
- *Undivided Ownership Interests.* A Transferor that co-owns an eligible credit property through a tenancy-in-common arrangement or pursuant to a joint operating arrangement that has properly elected out of subchapter K of chapter 1 of the Code under Section 761 may make a Transfer Election with respect to the Transferor’s ownership share of the eligible credit property.
- *Consolidated Group.* A member of a consolidated group must make a Transfer Election to transfer any eligible credit determined with respect to the member.
- *Partnership and S Corporations.* A partnership or S corporation that directly holds eligible credit property may make a Transfer Election at the partnership/S corporation level; partners and S corporation shareholders may not make a Transfer Election with respect to eligible credits that

are allocated to them. Additional rules applicable to partnerships and S corporations are discussed below.

### 3. Specific Rules Regarding Scope, Manner, and Timing of Transfer Elections

Although Code Section 6418 does not expressly provide for the relevant unit of measurement for a Transfer Election, the Proposed 6418 Regulations clarify that a Transferor must make a separate Transfer Election for each single eligible credit property (as discussed above). In the preamble to the Proposed 6418 Regulations, Treasury and the IRS have requested comments on two issues: (1) first, whether more specific guidance with respect to any eligible credit property is needed to allow Transferors to make the Transfer Election, and (2) whether to adopt a grouping rule that allows taxpayers to make an election with respect to certain groups of eligible credit properties.

*Timing Rules for Credits Claimed Over Multiple Tax Years.* In addition, for the PTC (Section 45), carbon oxide sequestration credit (Section 45Q), clean hydrogen production credit (Section 45V), or clean electricity production credit (Section 45Y), a Transfer Election must be made for each taxable year a Transferor transfers credits during the 10-year (or 12-year, for the carbon oxide sequestration credit) credit period beginning on the date the applicable credit property was originally placed in service.

*Manner and Due Date of Making a Valid Transfer Election.* To make a valid Transfer Election, a Transferor must include the following in its U.S. federal income tax return:

1. A properly completed relevant source credit form for the eligible credit (e.g., Form 7207 for the Section 45X credit) for the taxable year that the eligible credit was determined;
2. A properly completed Form 3800, including a schedule attached that shows the amount of the eligible credit transferred for each eligible credit property;
3. A “transfer election statement”; and
4. Any other information related to the election specified in applicable guidance.

The Transfer Election must be made by the Transferor on an original return not later than the due date (including applicable extensions of time to file) for the Transferor’s original return for the taxable year for which the eligible credit is determined. The Transferor may not make or revise a Transfer Election on an amended return or by filing an administrative adjustment request, and there is no late-election relief.

*Transfer Election Statement.* Both the Transferor and the Transferee must complete a transfer election statement, signed under penalty of perjury, and attach that transfer election statement to their respective returns.<sup>1</sup> The Proposed 6418 Regulations generally allow a transfer election statement to be completed any time after the Transferor and Transferee have sufficient information to prepare it, but it cannot be completed for any taxable year after the earlier of (i) the filing of the Transferor’s return for the taxable year for which the specified credit portion is determined with respect to the Transferor, or (ii) the filing of the Transferee’s return for the year in which the specified credit portion is taken into account.

*Limitations on the Transfer Election.* The Proposed 6418 Regulations include rules that describe certain limitations with respect to the Transfer Election: (1) a Transfer Election is irrevocable once made and (2) a Transferee may not make a second transfer with respect to the transferred credit. However, the

preamble to the Proposed 6418 Regulations states that a partnership or S corporation Transferee that allocates purchased eligible credits to its owners will not violate the second transfer rule because such an allocation would not be considered a transfer under Code Section 6418. This taxpayer-friendly rule will allow syndications of acquired eligible credits.

*Use of Brokers.* The preamble to the Proposed 6418 Regulations also states that an arrangement using a broker to match Transferors and Transferees should not violate the no second transfer rule, provided that the arrangement at no point transfers the tax credit ownership to the broker or to any taxpayer other than the Transferee.

#### 4. Determining the Eligible Credit

A Transferor may only transfer an eligible credit determined with respect to the Transferor, which means that the Transferor must either own the underlying eligible credit property or, if ownership is not required, otherwise conduct the activities giving rise to the underlying eligible credit. The Proposed 6418 Regulations therefore provide that an ITC allowable to a lessee of property as a result of an election under Treasury Regulation Section 1.48-4 is not an eligible credit that can be transferred. As a result, a lessee entity in a lease pass-through structure is ineligible to transfer a credit under Code Section 6418, even if the lessee entity may itself claim the credit.

In addition, all rules relating to the determination of the eligible credit, including the at-risk rules in Code Section 49 and the property ineligibility rules in Code Section 50(b), that apply to the Transferor will similarly limit the amount of the eligible credit available to the Transferee.

The Proposed 6418 Regulations also provide rules for the application of the Code Section 49 at-risk rules to a partnership or S corporation that makes a Transfer Election. Under those rules, any amount of eligible credit determined with respect to investment credit property held directly by a transferor partnership or transferor S corporation (or held directly by an entity disregarded as separate from such transferor partnership or transferor S corporation) is determined by the transferor partnership or transferor S corporation by taking into account the Code Section 49 at-risk rules at the partner or shareholder level as of the close of the taxable year in which the eligible credit property is placed in service.

#### 5. Treatments of Payments Made in Connection with a Transfer Election

*General Tax Treatment of Payments.* The Proposed 6418 Regulations state that the cash payment made to a Transferor as consideration for an eligible credit is not includable in the gross income of the Transferor, and it is not deductible by the credit transferee.

*Anti-Abuse Rule.* The Proposed 6418 Regulations also contain a broad anti-abuse rule providing that in circumstances where parties have engaged in a transaction with the principal purpose of avoiding any U.S. federal tax liability beyond the intent of Code Section 6418, the transfer may be disallowed, or the federal income tax consequences of any transaction effecting the transfer may be recharacterized. Two examples are included that specifically address transferring credits in transactions that are intended to decrease the eligible taxpayer's gross income or increase a transferee taxpayer's deductions.

*Transferee Taxpayer's Treatment of the Eligible Credit.* Code Section 6418(d) provides that the Transferee must take the eligible credit into account in the Transferee's first taxable year ending with or after the taxable year of the Transferor with respect to which the eligible credit was determined. Thus, if the taxable years of a Transferor and Transferee end on different dates, the Transferee will take

the transferred credit into account in the Transferee's first taxable year that ends after the taxable year of the Transferor. Although not expressly stated in the Proposed 6418 Regulations, the preamble states that a Transferee may also take into account the transferred credit that it has purchased (or intends to purchase) when calculating its estimated tax payments. In addition, a Transferee is not subject to tax on the transferred credit, even if the amount of cash paid by the Transferee is less than the amount of the transferred credit.

*Carryback and Carryforward.* Under the Proposed 6418 Regulations, transferee taxpayers are allowed a 3-year carryback period (as opposed to 1-year) to a specified credit portion to the extent that the specified credit portion is an "applicable credit" within the meaning of the direct payment election rules under Code Section 6417.

*Unanswered Questions & Requests for Comments.* Treasury and the IRS are considering and have requested comments on the tax treatment of transactions costs for the Transferor and the Transferee and whether a Transferee may deduct a loss if the amount of cash it paid for the eligible credit exceeds the amount of the eligible credit the Transferee is actually able to claim.

### **C. Additional Rules for Partnerships and S Corporations**

Under Code Section 6418, a Transferor that is a partnership or S corporation may make a Transfer Election at the partnership or S corporation level. If the partnership or S corporation makes the Transfer Election with respect to a credit for a facility or property that it holds directly, any amount received as consideration for the transfer will be treated as tax-exempt income for purposes of determining the basis of a partner's interest under Code Section 705 and for purposes of determining an S corporation shareholder's distributive share of income and loss under Code Section 1366. A partner's distributive share of the tax-exempt income will be based on the partner's distributive share of the transferred credit for each tax year, and such tax-exempt income from the transfer of credit would be treated as passive to those partners or shareholders that do not materially participate.

*Special Recapture Rules for Transferor Partnerships and S Corporations.* The Proposed 6418 Regulations provide Transferee-friendly clarification on whether indirect disposition events result in the recapture of transferred investment tax credits. Under the Proposed 6418 Regulations, a partner's or S corporation shareholder's disposition of its interest in a Transferor that is a partnership or S corporation do not result in recapture tax liability to the Transferee. Instead, the disposing partner or shareholder is subject to the rules relating to that disposition under Treasury Regulations Sections 1.47-6(a)(2) (regarding disposition of a partner's interest) or 1.47-4(a)(2) (regarding disposition of a shareholder's interest). It is unclear how this rule will apply if all of the disposing partners or shareholders transfer their interests in the Transferor.

Similar rules apply with respect to a change in nonqualified nonrecourse financing at the partner or shareholder level: the Proposed 6418 Regulations provide that such change does not cause recapture for which the Transferee is liable. Instead, a partner or shareholder in a partnership or S corporation that is a Transferor must apply the rules under Code Section 49 at the partner or shareholder level.

In the preamble to the Proposed 6418 Regulations, the Treasury and the IRS have requested comments on whether additional rules or clarifications are needed with respect to how the recapture rules under Code Section 49(b) apply to partnerships or S corporations. However, it is clear that any decreases in nonqualified nonrecourse financing in subsequent years may not be transferred.

*Partner's Eligible Credit Amount.* The Proposed 6418 Regulations provide that a partner's distributive share of tax-exempt income resulting from the receipt of consideration in exchange for an eligible credit is based on the partner's proportionate distributive share of the eligible credit that would have been allocated to such partner absent the credit transfer, and such amounts would be treated as received or accrued as of the date the specified credit portion is determined with respect to the Transferor partnership. The Proposed 6418 Regulations also include a special rule for allocations of tax-exempt income resulting from a transfer of a specified credit portion of less than all the eligible credits from an eligible property to, generally, be allocated to those partners that desired to transfer their share of the underlying credits.

*Elections for Transferor Partnerships and S Corporations.* Consistent with the rules for other Transferors, partnership and S corporations generally must make a Transfer Election as any other Transferor following the procedures in the Proposed 6418 Regulations described above, and all such documents accompanying the election to be attached to the partnership or S corporation return for the taxable year in which the transferred credit was determined.

#### **D. Pre-Filing Registration Requirements**

Proposed Treasury Regulation Section 1.6418-4(a), consistent with Code Section 6418(g)(1), requires that, as a condition of, and before, making an election to transfer a specified credit portion, a Taxpayer must satisfy the Pre-Filing Registration Requirements (discussed in more detail in Part II, below).

#### **E. Excessive Credit Transfers**

If any credit transferred is determined to be an "excessive credit transfer", the tax imposed on the Transferee for the taxable year in which the excessive credit transfer is determined will be increased by 120% of the amount of the excessive credit transfer. An "excessive credit transfer" is defined as, with respect to an eligible credit property for which a Transfer Election is made for any taxable year, an amount equal to the excess of (i) the amount of the transferred specified credit portion claimed by the Transferee with respect to that eligible credit property for that taxable year, over (ii) the amount of the eligible credit that, absent the Transfer Election, would otherwise have been allowed with respect to that eligible credit property for that taxable year. In effect, the Transferor bears the first risk of loss under this penalty provision which could offer an opportunity for a retention to offer some protection to Transferees with respect to "excessive credit transfers."

The Transferee's tax will only be increased by 100% of the amount of the excessive credit transfer if the Transferee demonstrates to the satisfaction of the IRS that the excessive credit transfer resulted from reasonable cause, based on the relevant facts and circumstances. The Proposed 6418 Regulations provide that the most important factor in this reasonable cause analysis is the extent of the Transferee's efforts to determine that the amount of the credit transferred was not more than the amount of credit determined with respect to the eligible credit property. Circumstances indicating reasonable cause may include review of the Transferor's records with respect to the determination of the credit (including documentation evidencing eligibility for bonus credit amounts), reasonable reliance on third-party expert reports (which may include appraisals and cost segregation studies), reasonable reliance on representations from the Transferor that the total credit amount transferred was not excessive, and review of audited financial statements provided to the Securities and Exchange Commission, if applicable. It is clear that Treasury believes that Transferees should be performing adequate diligence to confirm the qualification and amounts of the transferred credits in order to avoid this penalty.

The Proposed 6418 Regulations also state that for purposes of calculating whether there has been an excessive credit transfer with respect to an eligible credit, all Transferees are treated as one Transferee.

In addition, under the Proposed 6418 Regulations, a recapture event is not an excessive credit transfer.

## **II. Pre-Filing Registration**

Taxpayers making a Transfer Election must complete the Pre-Filing Registration Requirements described in the Temporary Regulations. Generally, proper completion of the applicable Pre-Filing Registration Requirements is required prior to making a Transfer Election.

### **A. General Requirements**

The Temporary Regulations provide the following Pre-Filing Registration Requirements:

1. The Transferor must complete a registration process electronically through the IRS portal and in accordance with the instructions provided in the portal (unless otherwise provided in future guidance). If the election is made by a member of a consolidated group, the member must complete this process.
2. The Transferor must satisfy the pre-filing registration requirements and receive a registration number prior to making a Transfer Election on the Transferor's tax return for the taxable year at issue.
3. The Transferor must obtain a registration number for each eligible credit property with respect to which it intends to make a Transfer Election; and
4. The Transferor must provide the specific information required to be provided as part of registration process, which includes the following:
  - a. The Transferor's general information;
  - b. Any additional information required by the IRS electronic portal;
  - c. The Transferor's taxable year;
  - d. The type of tax return normally filed by the Transferor;
  - e. The type of eligible credit for which the Transferor intends to make a Transfer Election;
  - f. Each eligible credit property that the Transferor intends to use to determine a specified credit portion for which the Transferor intends to make a Transfer Election;
  - g. For each eligible credit property, any further information required by the IRS electronic portal, such as (i) the type of eligible credit property, (ii) its physical location, (iii) supporting documentation relating to the construction or acquisition of the eligible credit property, (iv) the beginning-of-construction and placed-in-service dates of the eligible credit property, and (v) any other information that the Transferor believes will help the IRS evaluate the registration request;
  - h. The name of a contact person for the Transferor, whom the IRS may contact if there is an issue with the registration;



- i. A penalties of perjury statement signed by a person with personal knowledge of the relevant facts; and
- j. Any other information the IRS deems necessary for purposes of presenting duplication, fraud, improper payments, or excessive payments as provided in future guidance.

### **B. Registration Number**

The IRS will issue a separate registration number for each eligible credit property. That registration number is valid for the Transferor only for the taxable year for which it is obtained and for the Transferee only for the Transferee's taxable year in which the specified credit portion is taken into account. If the Transferor is transferring a portion of the credit to multiple Transferees in any particular year, then all Transferees would use the same registration number for the transfer.

If a Transfer Election will be made with respect to an eligible credit property for a taxable year after a registration number has been obtained, the Transferor must renew the registration. Thus, for credits taken over a multi-year period, such as the PTC, the registration will need to be renewed for each year within the credit period. Renewals will also be required in the event of an eligible credit property being placed in service in a year later than the initial registration being obtained, whether planned or as a result of unforeseen delays.

The Temporary Regulations also provide that if facts change with respect to an eligible credit property for which a registration number has been issued, the Transferor must amend the registration to reflect these new facts.

To make a valid Transfer Election, the Transferor and Transferee must each report the registration number of the eligible credit property on their respective U.S. federal income tax returns on which the Transfer Election is reported.

The Temporary Regulations apply to Transfer Elections made in taxable years ending on or after June 21, 2023.

### **III. Next Steps: Comment Period, Public Hearing & Future Guidance**

Treasury and the IRS have encouraged taxpayers and other interested parties to submit comments on the Proposed 6418 Regulations. Comments must be received by August 14, 2023, and a public hearing on the Proposed 6418 Regulations is scheduled to be held on August 23, 2023 at 10am ET. Those who wish to speak or that certain topics be discussed at the public hearing must submit requests to speak and outlines of topics to be discussed by August 14, 2023, and requests to attend the hearing must be received by August 21, 2023 at 5pm ET.

After the comment period closes and taxpayers have been given an opportunity to be heard at the public hearing, Treasury and the IRS will consider the input it receives and whether revisions to the Proposed 6418 Regulations are warranted. In the meantime, the Proposed 6418 Regulations provide more certainty to Transferors and Transferees negotiating tax credit transfer agreements or otherwise planning to implement transfer arrangements under Code Section 6418.

These new proposed regulations are a positive development for the renewable energy industry and should provide more comfort to participants in tax credit transfers and allow these transactions to move forward.



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

**New York**

Kenneth Bagdasar  
1.212.318.6622  
[kennethbagdasar@paulhastings.com](mailto:kennethbagdasar@paulhastings.com)

**Los Angeles**

Kami LaBerge  
1.213.683.6159  
[kamilaberge@paulhastings.com](mailto:kamilaberge@paulhastings.com)

Lena Son  
1.213.683.6115  
[lenason@paulhastings.com](mailto:lenason@paulhastings.com)

Michael D. Haun  
1.213.683.6119  
[michaelhaun@paulhastings.com](mailto:michaelhaun@paulhastings.com)

---

<sup>1</sup> A transfer election statement would be required to generally include:

- information related to the Transferee and the Transferor;
- a statement that provides the necessary information and amounts to allow the Transferee to take into account the specified credit portion with respect to the eligible credit property;
- a statement that the parties are not related;
- representation from the Transferor that it has complied with all relevant requirements to make a transfer election;
- a statement from the Transferor and the Transferee acknowledging the notification of recapture requirements; and
- a statement or representation from the Transferor that it has provided the required minimum documentation to the Transferee.

**Paul Hastings LLP**

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2023 Paul Hastings LLP.