Locke Lord Deep Dive: Treasury Issues Final Regulations Providing Guidance on Transfer of Certain Credits Under the Inflation Reduction Act

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On April 30, 2024, the Internal Revenue Service ("IRS") and the U.S. Treasury Department ("Treasury") published Final Treasury Regulations **(T.D. 9993)** (the "Final Regulations") providing guidance relating to the election under Section 6418 of the Internal Revenue Code of 1986, as amended (the "Code"), to transfer certain tax credits (the "Transfer Election"). The Final Regulations follow previously issued Proposed Treasury Regulations (**REG-101610-23**) (the "Proposed Regulations") and Temporary Regulations (**T.D. 9975**) (the "Temporary Regulations"), each published in June 2023, which provided guidance with respect to the Transfer Election and set forth mandatory information and registration requirements for making Transfer Elections. The Final Regulations, effective on July 1, 2024, serve to finalize the Proposed Regulations and remove the Temporary Regulations. The Final Regulations largely conform to the Proposed and Temporary Regulations, with a few changes and several clarifications. This Deep Dive provides background with respect to the Transfer Election and discusses the key changes and clarifications set forth in the Final Regulations.

A. Background

The Inflation Reduction Act of 2022 (the "IRA") created two credit monetization mechanisms: (1) the Transfer Election under Code Section 6418, whereby eligible taxpayers can freely transfer certain federal tax credits to third parties for cash (if all applicable requirements are met), and (2) the elective payment election (the "Direct Pay Election") under Code Section 6417, whereby specified tax-exempt entities (and certain other entities) can elect to have certain energy credits treated as refundable credits rather than their ordinary treatment as nonrefundable offsets to taxpayers' tax liabilities (effectively allowing such tax-exempt organizations to have the value of an applicable tax credit paid directly to them by the IRS, despite not having any (or having very limited) taxable income). More information on the Direct Pay Election can be found in **our QuickStudy discussing the March 2024 Final Treasury Regulations published under Code Section 6417**.

The Transfer Election allows eligible taxpayers to transfer all or a portion of eligible credits to unrelated taxpayers. When a Transfer Election is made, any consideration paid by the transferee taxpayer to the eligible taxpayer for the transfer of eligible credits (1) is required to be paid in cash, (2) is not included in the eligible taxpayer's gross income, and (3) is not allowed as a deduction to the transferee taxpayer under any provision of the Code. Thus, this election allows eligible taxpayers to transfer their eligible credits in exchange for tax-free immediate funds, so that such taxpayers can take advantage of tax incentives if they do not have sufficient tax liability to fully utilize the credits themselves. The Transfer Election serves to provide new sources of capital to developers and owners of renewable energy projects by allowing them to monetize eligible credits through a one-time sale of a renewable energy credit to an unrelated party. The Transfer Election is available for the following eligible credits:

1. Credits for alternative fuel vehicle refueling property (Code Section 30C);
2. Renewable electricity production credits ("PTCs") (Code Section 45);
3. Credits for carbon oxide sequestration (Code Section 45Q);
4. Zero-emission nuclear power production credits (Code Section 45U);
5. Clean hydrogen production credits (Code Section 45V);


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6. Advanced manufacturing production credits (Code Section 45X);
7. Clean electricity production credits (Code Section 45Y);
8. Clean fuel production credits (Code Section 45Z);
9. Energy credits ("ITCs") (Code Section 48);
10. Qualifying advanced energy project credits (Code Section 48C); and
11. Clean electricity investment credits (Code Section 48E).

Any taxpayer that is not an "applicable entity" under Code Section 6417(d)(1)(A) is entitled to make a Transfer Election (such a taxpayer, an "Eligible Taxpayer"), with such applicable entities generally including all tax-exempt organizations, state and local governments, Indian tribal governments, the Tennessee Valley Authority, Alaska Native Corporations, rural electric cooperatives, and in the case of tax credits under Code Sections 45Q, 45V and 45V, other taxpayers electing to be treated as applicable entities (such entities, "Applicable Entities").

To qualify for the election, an Eligible Taxpayer must make a Transfer Election to transfer any portion of an eligible credit on its original tax return for the taxable year for which the credit is determined. The Transfer Election must be made by the due date of such return (including extensions of time to file) and is irrevocable. An eligible credit can only be transferred once pursuant to a Transfer Election, meaning a transferee taxpayer may not make any additional transfers of a transferred eligible credit under Code Section 6418.

B. Key Changes and Clarifications.

The Final Regulations largely conform to the previously issued Proposed and Temporary Regulations, but include a few changes and several clarifications, including:

- *Partnerships Owned by Applicable Entities*. The Proposed Regulations defined an Eligible Taxpayer as any taxpayer that is not an Applicable Entity. A commenter to the Proposed Regulations requested clarification that a partnership wholly or partially owned by one or more Applicable Entities may qualify as an Eligible Taxpayer. The Preamble to the Final Regulations (the "Preamble") confirms that if a tax partnership has not elected to be treated as an Applicable Entity for purposes of making Direct Pay Elections with respect to credits under Code Sections 45V, 45Q, or 45X, it may qualify as an Eligible Taxpayer, regardless of whether such tax partnership is owned by one or more Applicable Entities. However, the Preamble further clarifies that Code Section 50(b)(3) and (4) may limit the amount of ITCs determined with respect to any tax-exempt or government entity partner.
- *Energy Storage Technology as Eligible Credit Property.* The preamble to the Proposed Regulations provided in part that "energy property" is comprised of all components of property necessary to generate electricity up to the point of transmission or distribution. However, a commenter raised that "energy storage technology" is specifically designated as energy property under Code Section 48(a)(3)(A)(ix), but unlike other forms of energy property, it does not generate electricity. The Preamble confirms that a credit with respect to energy storage technology is an eligible credit that can be transferred pursuant to a Transfer Election.
- *Code Section 45Q Eligible Credit Property.* The Proposed Regulations provided that for purposes of the credit under Code Section 45Q, an eligible credit is determined based on a single process train of carbon capture equipment. Commenters requested that the Final Regulations reconcile the Proposed Regulations with Rev. Rul. 2021-13, 2021-30 I.R.B. 152, under which a taxpayer need own only one component in a single process train to be the person to whom the Code Section 45Q credit is attributable to (assuming the taxpayer also meets the requirements of Code Section 45Q(a), as applicable). The Final Regulations implement this request, revising the Proposed Regulations to define eligible credit property with respect to the credit under Section 45Q as "a component of carbon capture equipment within a single process train described in Treas. Reg. 1.45Q-2(c)(3)."
- *Paid in Cash.* Code Section 6418(b)(1) requires that any amount paid by a transferee taxpayer to an Eligible Taxpayer as consideration for a transfer be paid in cash. The Proposed Regulations defined the term "paid in cash" to mean a payment in United States dollars that (1) is made by cash, check, cashier's check, money order, wire transfer, ACH transfer, or other bank transfer of immediately available funds; (2) is made within the period beginning on the first day of the Eligible Taxpayer's taxable year during which a specified credit portion is determined and ending on the due date for completing a transfer election statement; and (3) may include a transferee taxpayer's contractual commitment to purchase eligible credits with United States dollars in advance of the date a specified credit portion is transferred to such transferee taxpayer if all payments are made in a manner that satisfies the first two

requirements. Commenters recommended revising the proposed paid in cash rule so that advanced payments could be made for eligible credits that will be determined in later years, specifically requesting that the Final Regulations allow upfront payments for transfers of PTCs that are expected to be determined in future taxable years. The Final Regulations reject these recommendations, adopting the language of the Proposed Regulations with respect to the paid in cash rule. In rejecting these recommendations, the Preamble notes that although allowing advanced payments prior to the taxable year an eligible credit is determined may more closely align the Code Section 6418 regulations with current tax equity transactions, allowing such advanced payments would raise several complex legal and administrative issues. Nonetheless, the Preamble (1) clarifies that there is no prohibition on either a transferee taxpayer or another third-party loaning funds to an Eligible Taxpayer, provided such loans are at arm's length and treated as loans for Federal Tax purposes, and (2) further states that whether such loans are treated as upfront payments for eligible credits or otherwise recharacterized is a facts and circumstances analysis outside the scope of the Final Regulations.

- *Specified Credit Portion.* Code Section 6418(a) provides that an Eligible Taxpayer can elect to transfer all (or any portion specified in the election) of an eligible credit determined with respect to such taxpayer. The Proposed Regulations defined the term "specified credit portion" to mean a proportionate share (including all) of an eligible credit determined with respect to a single eligible credit property of the Eligible Taxpayer that is specified in a Transfer Election. The Proposed Regulations further provided that a specified credit portion of an eligible credit reflects a proportionate share of each bonus credit amount that is taken into account in calculating the entire amount of eligible credit determined with respect to a single eligible credit property. Thus, under the Proposed Regulations, an Eligible Taxpayer would be permitted only to transfer the entire eligible credit (or a portion thereof, which would include a proportionate amount of any bonus credit amounts taken into account to determine the entire eligible credit) determined with respect to a single eligible credit property (i.e., a "vertical slice"). Commentators recommended that bonus credit amounts should be transferable apart from the base eligible credit amount (i.e., a "horizontal slice"), but the Final Regulations decline these recommendations and adopt the definition of a "specified credit portion" from the Proposed Regulations.
- *Grantor Trusts.* The Proposed Regulations provided rules for Transfer Elections in certain ownership situations, specifically with respect to ownership through a disregarded entity, as an undivided ownership interest, as a member of a consolidated group, and for partnerships and S corporations. A Commenter requested the Final Regulations provide clarity regarding whether a grantor trust is treated as a disregarded entity in determining ownership of an eligible credit property, and, if a grantor trust directly holds an eligible credit property, which party registers the property and makes a Transfer Election. Granting such clarity, the Final Regulations provide that if an Eligible Taxpayer is a grantor or any other person that is treated as the owner of any portion of a trust as described in Code Section 671, then 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 under Code Section 671.
- *Credits "Determined with Respect to" an Eligible Taxpayer.* The Proposed Regulations provided that an Eligible Taxpayer can only elect to transfer eligible credits which are "determined with respect to" that taxpayer. Thus, under the Proposed Regulations, the Eligible Taxpayer must own the underlying eligible credit property. Commenters recommended revising the Proposed Regulations to allow Eligible Taxpayers to make Transfer Elections with respect to certain credits that are not determined with respect to the electing Eligible Taxpayer. The Final Regulations largely adopt the language of the Proposed Regulations but clarify that the only eligible credit for which ownership of the underlying eligible credit property is not required is the credit under Code Section 45X (which credit is determined with respect to the taxpayer who conducts the activities giving rise to the underlying applicable credit). The Preamble further clarifies that (1) Transfer Elections are prohibited for credits attributed to an Eligible Taxpayer pursuant to an election under Code Section 45Q(f)(3)(B) and for credits transferred to a lessee from a lessor pursuant to a lease passthrough election under Code Section 50(d), and (2) the owner-lessor in a sale-leaseback transaction can make a Transfer Election.
- *Amended Returns.* The Proposed Regulations provided that a Transfer Election must be made on an original return not later than the due date (including extensions) for the original return of the Eligible Taxpayer for the taxable year for which the eligible credit is determined. The Proposed Regulations stated that no Transfer Election could be made or revised on an amended return or by filing an administrative adjustment request (an "AAR") under Code Section 6227. The Proposed Regulations also did not provide for relief under Treasury Regulations Sections 301.9100-1 through 301.9100-3 (the "9100 Relief Provisions"). Commenters requested that a Transfer Election be permitted on an amended return or AAR and/or that a taxpayer be permitted an extension of time under the

9100 Relief Provisions to make a late election. The Final Regulations largely reject these requests but revise the Proposed Regulations to clarify that (1) a Transfer Election filed by an electing taxpayer may be made or revised on a superseding return (a return filed subsequent to the originally-filed return but before the due date for filing the return, including extensions), (2) a Transfer Election cannot be made, revised, or withdrawn on an amended return, or by filing an AAR, and (3) a numerical error with respect to a properly claimed Transfer Election may be corrected on an amended return (for example, miscalculating the amount of the eligible credit on the original return or making a typographical error in the process of inputting a registration number). The Final Regulations further modify the Proposed Regulations to permit an extension of time under Treasury Regulation Section 301.9100-2(b) to allow for an automatic six-month extension of time from the due date of the return (excluding extensions) to make a late Transfer Election. However, the Preamble clarifies that (1) because a Transfer Election is a statutory election, the 9100 Relief Procedures only apply insofar as the late election is being filed pursuant to Treasury Regulation Section 301.9100-2(b), which requires that the relevant taxpayer timely filed its return for the year the election should have been made, (2) relief under Treasury Regulation Section 301.9100-2(b) will only apply to taxpayers that have not received an extension of time to file a return after the original due date, and (3) taxpayers eligible for such relief must take corrective action under Treasury Regulation Section 301.9100-2(c) and follow the procedural requirements of Treasury Regulation Section 301.9100-2(d).

- *Partnership Agreements as Transfer Election Statements.* The Proposed Regulations defined a "transfer election statement" as a written document that describes the transfer of a specified credit portion between an Eligible Taxpayer and transferee taxpayer. The Proposed Regulations further provided that any document that meets the requirements of the Proposed Regulations can be used as the transfer election statement. The Final Regulations adopt the language of the Proposed Regulations, and the Preamble clarifies that a transfer election statement can be a partnership agreement if the document otherwise meets the applicable requirements.
- *Responsibility for Substantiating an Increased Credit Amount.* A commenter to the Proposed Regulations requested clarification that any responsibility to engage in regular reporting of certified payroll, apprentice labor hour reports, or other obligation under the prevailing wage and apprenticeship requirements for transferred specified credit portions remains with the Eligible Taxpayer. The Preamble clarifies that the responsibility of determining a credit is initially with the Eligible Taxpayer, and the transfer of an eligible credit does not relieve an Eligible Taxpayer of this responsibility or the responsibility to substantiate the credit. The Preamble further clarifies that upon a Transfer Election, the responsibility for substantiating an increased credit amount pursuant to the prevailing wage and apprenticeship requirements does not shift to the transferee taxpayer, although a transferee taxpayer may be treated as the relevant taxpayer for other purposes under the IRA.
- *Multiple Transfers.* The Proposed Regulations provided that a specified credit portion may only be transferred pursuant to a Transfer Election once (disallowing subsequent transfers after transferring eligible credits to a broker). Commenters advocated for the Final Regulations to allow multiple transfers of specified credit portions in certain transactions with brokers or other taxpayers. The Final Regulations reject these requests, adopting the "no additional transfer" rule of the Proposed Regulations. However, the Preamble clarifies that it is unnecessary to apply the normal "benefits and burdens" principles to determine whether a transfer has been made. Rather, the Preamble further clarifies that a transfer only occurs when all the requirements of Section 1.6418-2 of the Final Regulations are satisfied, and until that time, there is no valid transfer and no transferee taxpayer. The Preamble further clarifies that to the extent there are brokers or other taxpayers providing liquidity with respect to a transfer of credits, any payments received by those brokers or other taxpayers related to eligible credits will be taxable because the provisions of Code Section 6418 will not prevent the inclusion of gross income for such taxpayers, or for any amounts received by an Eligible Taxpayer other than amounts paid by a transferee taxpayer in consideration for the eligible credit.
- *Anti-Abuse Provision; Principal Purpose Standard.* The Proposed Regulations included an anti-abuse provision which provided that a Transfer Election of any specified credit portion (and therefore the transfer of such specified credit portion to a transferee taxpayer), may be disallowed, or the Federal income tax consequences of any transaction(s) effecting such a transfer may be recharacterized, in circumstances in which the parties to the transaction have engaged in the transaction or a series of transactions with "the" principal purpose of avoiding any Federal tax liability beyond the intent of Code Section 6418. However, discrepancies in the language of the Proposed Regulations made it unclear whether the standard of this anti-abuse rule was that parties to the transaction engaged in the transaction with "the" or "a" principal purpose of such tax avoidance. The Final Regulations clarify that the standard for applying the anti-abuse rule is whether "a" principal purpose of engaging in the relevant credit transfer transaction was

the avoidance of Federal tax liability beyond the intent of Code Section 6418, rather than requiring that such tax avoidance was "the" principal purpose.

- *Anti-Abuse Provision; Adequate Pricing.* In determining whether a credit transfer transaction is subject to recharacterization under the anti-abuse provision, examples within the Proposed Regulations would have compared the price of such transactions to "the average transfer price of the eligible credit between unrelated parties." Commenters raised concerns about the availability of pricing information and noted that it would be administratively burdensome for the IRS to regularly organize, develop and publish such information. Accordingly, the Final Regulations amend the relevant examples to clarify that the price of a credit transfer transaction will be compared to "an arm's length price of the eligible credit without regard to other commercial relationships." The Preamble further clarifies that the intent of the anti-abuse rule is to allow recharacterization if the price paid is not economically supportable and is unreasonable based on the facts and circumstances of the transaction.
- *Taxable Year.* Code Section 6418(d) provides that a transferee taxpayer takes the transferred eligible credit into account in its first taxable year ending with, or after, the Eligible Taxpayer's taxable year with respect to which the transferred eligible credit was determined. The Proposed Regulations adopted this rule and further provided that (1) to the extent the taxable years of an Eligible Taxpayer and a transferee taxpayer end on the same date, the transferee taxpayer will take the specified credit portion into account in that taxable year, and (2) to the extent the taxable years of an Eligible Taxpayer and a transferee taxpayer end on different dates, the transferee taxpayer will take the specified credit portion into account in the first taxable year that ends after the taxable year of the Eligible Taxpayer. The Final Regulations largely adopt the language of the Proposed Regulations, but include a rule clarifying that, for purposes of determining the taxable year in which a transferred credit is taken into account by a transferee taxpayer, a 52-53 week taxable year of an Eligible Taxpayer or transferee taxpayer is deemed to end on or close on the last day of the calendar month nearest to the last day of the 52-53 week taxable year, as the case may be. Accordingly, the Preamble clarifies that in a situation in which an Eligible Taxpayer with a calendar year transfers credits to a transferee taxpayer with a 52-53 week taxable year ending on the last Saturday in December, the transferee taxpayer and the Eligible Taxpayer would be deemed to have the same year end, and the transferee taxpayer would not have to wait until the following year-end to take the eligible credit.
- *Passive Credit Rules.* The Proposed Regulations provided that a specified credit portion transferred to a transferee taxpayer is determined in connection with the conduct of business and, if applicable, such transferred credit portion is subject to the passive credit rules under Code Section 469. Commenters provided several suggestions regarding this rule, recommending that the passive credit rules should not apply to transferred specified credit portions or that the passive credit rules should otherwise be applied in a different manner than as provided in the Proposed Regulations. The Final Regulations decline to adopt such recommendations and instead adopt the language of the Proposed Regulations, with the addition of a few clarifying provisions, including (1) that a transferee taxpayer who directly owns an interest in an Eligible Taxpayer's trade or business at the time the work was done (as required for the material participation rules), is not deemed to fail the requirements of Code Section 469(h), and (2) that if an individual transferee does not materially participate in the activity that generates a specified credit portion, a transferred specified credit portion will be treated to the transferee taxpayer as arising in connection with a passive activity.
- *Estimated Tax Payments.* The Preamble to the Proposed Regulations explained that a transferee taxpayer could take into account a specified credit portion that it has purchased, or "intends to purchase," to calculate its estimated tax payments. Commenters requested that the Final Regulations include a specific rule on how transferred credits could be taken into account for purposes of calculating estimated tax, but the Final Regulations decline to do so, thereby adopting the language from the Proposed Regulations. The Preamble clarifies that (1) because Code Section 6418 generally contemplates a transferee taxpayer effectively stepping into the shoes of the Eligible Taxpayer from whom the transferee taxpayer was transferred the eligible credit, it follows that a transferee taxpayer can take into account the eligible credit for purposes of determining its quarterly estimated tax liability no earlier than an Eligible Taxpayer would, and (2) if a transferee taxpayer is required to take a transferred eligible credit into account in a taxable year that has not yet begun, then a transferee taxpayer cannot take the eligible credit into account for purposes of determining quarterly estimated tax liability until after the start of that later year. The Preamble further clarifies that the "intends to purchase" language (1) refers to a situation in which a taxpayer intends to complete a transaction that meets the requirements of Code Section 6418 so that the taxpayer would qualify as a transferee taxpayer with respect to a specified credit portion, but has not yet done so, and (2) illustrates that all the requirements of a tax credit transfer under Code Section 6418 do not have to be met for a transferee taxpayer to take the expected eligible credit into account in its estimated tax calculations.

- *Partnership Allocations.* The Proposed Regulations included complex rules regarding the allocation from an Eligible Taxpayer partnership to its partners of specified credit portions or tax-exempt income resulting from the transfer of such specified credit portions. Commenters suggested various means of simplifying these allocation rules; however, the Final Regulations largely reject these suggestions, with the Preamble stating that the complexity of the allocation rules is warranted given the flexibility they provide to taxpayers operating through transferor partnerships. However, the Final Regulations clarify that, assuming the agreement between the partners as to 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, is properly treated as part of the partnership's agreement, such amounts can be made or revised under Code Section 761(c) up until the due date (not including extensions) of the partnership's annual tax return.
- *Pre-Filing Registration.* The Proposed and Temporary Regulations established a mandatory pre-filing registration process that an Eligible Taxpayer would generally be required to complete as a condition of, and prior to, the transfer of an eligible credit. The Final Regulations decline various recommendations regarding this process and largely adopt the pre-filing registration rules from the Proposed and Temporary Regulations. However, the Preamble states that the IRS will continue to consider requests for a more streamlined pre-filing registration process. The Preamble also recommends that taxpayers register as soon as reasonably practicable during the tax year, noting that the current recommendation is to submit the pre-filing registration at least 120 days prior to when the organization or entity plans to file its tax return. Doing so "should allow time for IRS review, and for the taxpayer to respond if the IRS requires additional information before issuing the registration numbers."
- *Excessive Credit Transfers*.
  - *Examination Procedures* – Pursuant to Code Section 6418(g)(2)(A), if the IRS determines that there is an excessive credit transfer to a transferee taxpayer, then the tax imposed on the transferee taxpayer is increased in the year of such determination by the amount of the excessive credit transfer plus 20 percent of such excessive credit transfer. The Proposed Regulations defined the taxable year of determination as the taxable year that includes the determination of the excessive credit transfer to the transferee taxpayer and not the taxable year during which the eligible credit was originally determined by the Eligible Taxpayer, unless those are the same years. The Final Regulations adopt this definition; however, the Preamble clarifies that any credit transfer determination will be made by the IRS under established examination procedures and that the Final Regulations do not except any taxpayers or any calculations from this process. The Preamble further provides that an Eligible Taxpayer or transferee taxpayer may challenge an adverse determination by the IRS with respect to an excess credit transfer determination if the determination creates a tax deficiency, for which deficiency procedures apply, including the right to petition the U.S. Tax Court.
  - *Payments Directly Related to an Excessive Credit Transfer* – The Proposed Regulations provided that any payments made by a transferee taxpayer to an Eligible Taxpayer that directly relate to an excessive credit transfer are includible in the gross income of the Eligible Taxpayer. The Final Regulations revise the Proposed Regulations to clarify that any payment made by a transferee taxpayer to an Eligible Taxpayer that directly relates to an excessive credit transfer (1) is includible in the gross income of the Eligible Taxpayer, and (2) may be deductible by the transferee taxpayer. The Final Regulations further clarify that the amount of a payment that directly relates to an excessive credit transfer is equal to the total consideration paid in cash by the transferee taxpayer for its specified credit portion multiplied by the ratio of the amount of the excessive credit transferred to the transferee taxpayer to the amount of the transferred specified credit portion claimed by the transferee taxpayer.
  - *Reasonable Cause* – Code Section 6418(g)(2)(B) provides that, if a transferee taxpayer adequately demonstrates that an excessive credit transfer resulted from reasonable cause, the excessive credit transfer addition to tax will not apply. The Proposed Regulations provided that the determination of reasonable cause will be made based on the relevant facts and circumstances. The Final Regulations adopt the Proposed Regulations in defining "reasonable cause" for these purposes. The Preamble clarifies that generally, the most important factor 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 more than the amount of the eligible credit determined with respect to the eligible credit property for the taxable year in which the eligible credit was determined and has not been transferred to any other taxpayer. The Final Regulations also specifically place a due diligence responsibility on the transferee partner, with the Preamble clarifying that a transferee taxpayer relying solely on an Eligible Taxpayer's representations does not satisfy such responsibility.

- *Recapture;*
  - » *Risk of Recapture* – The Proposed Regulations provided that if, during any taxable year, certain recapture events occur with respect to any transferred credits, then (1) the Eligible Taxpayer must provide notice of such occurrence to the transferee taxpayer, and (2) the transferee taxpayer must provide notice of the recapture amount, if any, to the Eligible Taxpayer. The Proposed Regulations further provided that the recapture amount is calculated and taken into account by the transferee taxpayer, thereby allocating the risk of recapture solely to the transferee taxpayer. Commenters provided several recommendations suggesting that the risk of recapture upon such events should be allocated to the Eligible Taxpayer. Nonetheless, the Preamble states that the Treasury and 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 (that is, other than Code Section 50(a) and 49(b) recapture events involving transfers of interests by partners in a transferor partnership or shareholders in a transferor S corporation). The Final Regulations adopt the Proposed Regulations without change on this issue.
  - » *Allocation of Recapture Liability* – Commenters to the Proposed Regulations requested clarification as to the allocation of recapture liability between an Eligible Taxpayer and a transferee taxpayer to the extent the Eligible Taxpayer retains any eligible credits. 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 Treasury Regulations Sections 1.47-6(a)(2) or §1.47-4(a)(2), respectively, recapture liability applies proportionately to any transferee taxpayers 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 (1) add formulas for determining the recapture amount for which a transferee taxpayer and an Eligible Taxpayer is responsible for, (2) clarify the effect 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 (3) provide two examples to illustrate who is responsible for recapture in the case 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.
  - » *Duplicate Recapture of the Same ITC* – Commenters to the Proposed Regulations urged the Treasury and IRS to mitigate instances of duplicate recapture of the same ITC, and the Preamble notes that the Treasury and IRS agree that a single ITC should not be subject to duplicate recapture. Accordingly, 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 under Code Sections 50(a) or 49(b) that does not result in recapture liability to a transferee taxpayer pursuant to Section 1.6418-3(a)(6) of the Final Regulations, 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.
- *Credit Carryforward.* The Proposed Regulations provided that a transferee taxpayer can apply the rules in Code Section 39(a)(4) (regarding a 3-year carryback period for unused current year business credits) to a specified credit portion. In response to comments requesting confirmation that the transferee taxpayer should also be able to carryforward an unused credit amount, the Final Regulations clarify that a transferee taxpayer can apply to a specified credit portion both the carryback and carryforward provisions of Code Section 39(a)(4).
- *REITs.* With respect to real estate investment trust ("REIT") qualification, commenters requested that the Final Regulations clarify that eligible credits that have not yet been transferred are disregarded for purposes of the REIT Asset Test under Code Section 856(c)(4)(A)-(B). In response to these comments, the Final Regulations provide that eligible credits that have not yet been transferred are disregarded for purposes of the REIT Asset Test. The Final Regulations further clarify that a transfer of a specified credit portion pursuant to a valid Transfer Election is not a sale of property for purposes the "seven sales" safe harbor found in Code Sections 857(b)(6)(C)(iii) or 857(b)(D)(iv), with the Preamble noting that the Treasury and IRS agree that participation in the transfer of eligible credits should not burden all of a REIT's sales of real property
- *Normalization.* The Proposed Regulations did not address the impact of the normalization rules described in Code Section 50(d)(2) on eligible credit transfers of ITCs. Although several commenters requested guidance on this issue, the Final Regulations decline to adopt any specific rules addressing such normalization rules. However, the Preamble clarifies that (1) an Eligible Taxpayer is not subject to the normalization rules with respect to any cash consideration paid by a transferee taxpayer for a specified credit portion, and (2) any portion of an eligible credit that is not transferred would remain subject to the normalization rules, as applicable.

C. Conclusion.

The Transfer Election provides a major incentive for taxpayers investing in renewable energy projects by providing new sources of capital to developers and owners of such projects. The Final Regulations closely align with the Proposed and Temporary Regulations; however, taxpayers should be aware of the nuances discussed above to ensure their Transfer Elections are properly undertaken and respected. For additional information and context regarding the Transfer Election or the IRA, or to otherwise discuss the energy communities issues further, please contact one of the authors.