Federal Transferable Tax Credits from the IRA; Key Points, Benefits, and Eligible Taxpayers

ARMAGH CAPITAL

APRIL 23, 2024

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What are the benefits?

CASH SAVINGS ON FEDERAL TAXES

The most immediate benefit of utilizing Federal renewable energy tax credits is the cash discount to face value. Again, this discount to face value is not taxable.

SUSTAINABILITY

Many corporations, and especially financial institutions, are rated on their sustainability achievements. Tax credits derived from renewable energy investments will almost certainly be beneficial to such corporate objectives.

RECOGNITION IN PUBLIC DOCUMENTS/DISCLOSURES

Most sponsors will be agreeable to usage of project photographs and other media within annual reports, press releases, social media, etc.

Overview

CREATION OF TRANSFERABLE, FEDERAL TAX CREDITS FOR CLEAN ENERGY

On August 16th, 2022, President Biden signed H.R. 5376, the Inflation Reduction Act of 2022, which enacted several comprehensive clean and renewable energy provisions.

In order to further incentivize this development, this legislation created 26 U.S. Code § 6418 for "*Transfer of Certain Tax Credits*". This enables the transfer of Federal tax credits without an equity investment or partnership allocation, much like certificated tax credits available in some states.

Overview

TYPES OF CLEAN ENERGY TAX CREDITS

- Alternative Fuel Refueling Property (§ 30C)
- Production Tax Credit (§ 45)
- Carbon Oxide Sequestration (§ 45Q)
- Zero-Emission Nuclear Power Production (§ 45U)
- Clean Hydrogen Production (§ 45V)
- Advanced Manufacturing Production (§ 45X)
- Clean Electricity PTC (§ 45Y)
- Clean Fuel Production (§ 45Z)
- Investment Tax Credit (§ 48)
- Qualifying Advanced Energy project (§ 48C)
- Clean Electricity ITC (§ 48E)

INITIAL RULES FOR TRANSFERABILITY

Taxpayers may elect to transfer all, or a portion, of the tax credits.

- A one-time transfer is allowed;
- Credits are required to be paid for in cash;
- Any discount achieved on utilizing the credits is not taxable; and
- A 20% penalty could apply if any excess credits are transferred.

Key Points for Buyers

TIMING

- Credits must be purchased before the Seller files its annual tax return for the year, including extensions; and,
- The purchase price must be paid between the first day of the Seller's tax credit year and the earlier of the date that the Seller or Buyer files its annual tax return.

ELIGIBILITY

Taxpayers eligible to utilize these credits include:

- C Corporations (exempt from the passive activity rules); and,
- Taxpayers with passive income tax liabilities such as family wealth offices, certain real estate investors, etc.

CREDIT USAGE

- Can be used up to 75% of a tax year's liability;
- Carried back 3 years or carried forward 20 (sometimes 22) years; and,
- Buyer's CPA/tax advisors to attach IRS Form 3800 and a "transfer election statement" to the annual tax return.

Key Points for Buyers *continued*

DUE DILIGENCE

Buyers should conduct due diligence before purchasing Federal tax credits, including:

- Documentation that the project(s) exist, were placed in service, and are operational;
- Verification that developers have complied with, or are exempted from, wage and apprentice requirements; and,
- Confirmation that developers qualified for any bonus credits/adders included in the transferred credits.

PURCHASE TERMS

- Credits must be purchased 100% in cash and at market value;
- Buyer and Seller cannot be related (more than 50% common ownership);
- Production Tax Credits (PTCs) Buyers are required to purchase on a year-by-year basis;
- Investment Tax Credits (ITCs): Credits are allowed to be purchased as generated up front; and,
- Credits cannot be resold.

TAX ATTRIBUTES

- Cash amounts paid for the credits are not deductible; and,
- Any spread (discount) earned on the credits used is not taxable income.

What are the risks?

RISKS

- Recapture on ITCs – Recapture could occur if there is a disposition of the project within five years of the placed in service date, or if part of the project goes out of service; and,
- Disallowance – Disallowance on credits could also occur due to other reasons, such as inflated tax basis calculations. In such cases, the Buyer is responsible for 120% of any disallowed credits (disallowed credit + a 20% penalty).

HOW THESE RISKS ARE MITIGATED

- <u>Due diligence/cost segregation report</u> – This is a third-party, independent analysis of the project's costs, depreciation schedules and assessment of the ITCs/PTCs generated for the tax year;
- <u>Property insurance</u> – Since the vesting period for ITCs is five years, Buyers should verify that property insurance is in place for renewable energy installation;
- <u>Indemnification to Purchaser</u> – Buyers should request an indemnification from the sponsor for any disallowed credits as part of any tax credit transfer agreements, unless other warranties/guarantees are in place; and,
- <u>Other due diligence documents</u> – In addition, due diligence of other documents is key, such as prevailing wage/apprenticeship information, placed in service verification, permits, engineering reports, entity information, etc.

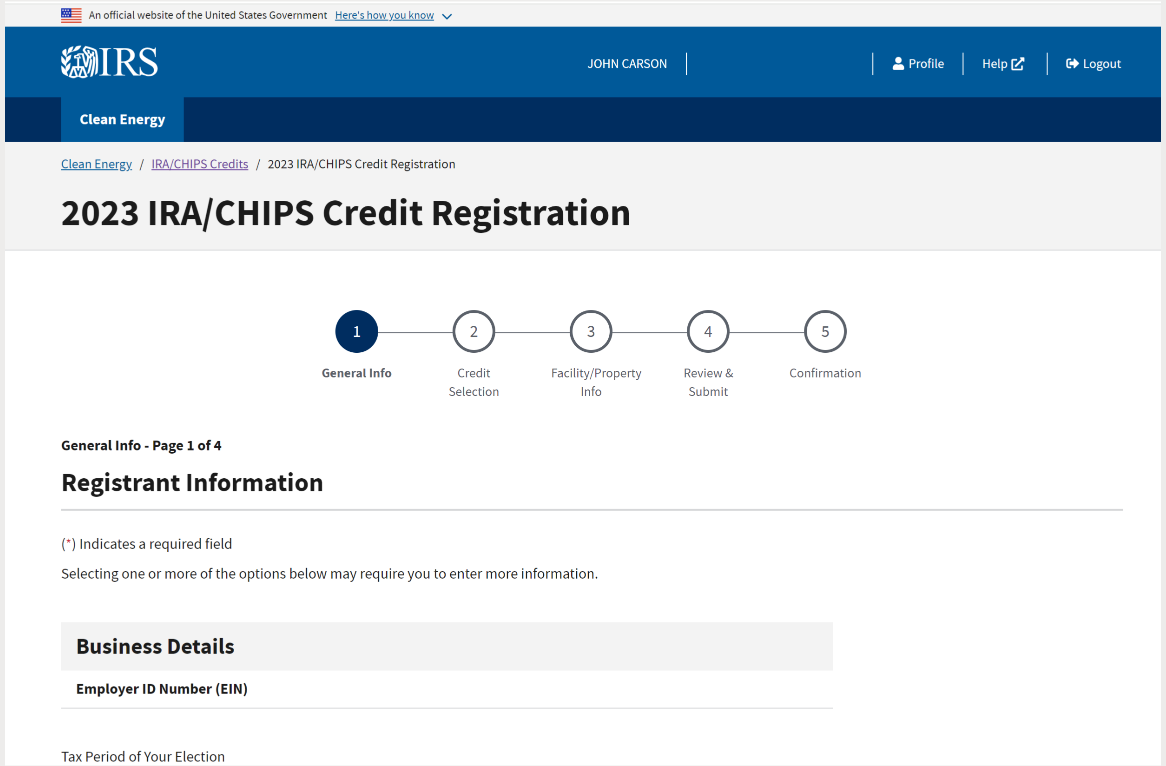
How are credits transferred and reported?

TRANSFER PROCESS

The Federal renewable energy tax credits are transferred through a newly created IRS portal.

This process documents the generation of the credits to be transferred, and includes sponsor, project descriptions, location, supporting documents, etc.

The IRS usually takes several weeks to complete this prefiling registration.



How are credits transferred and reported?

REPORTING OF THE CREDITS

As noted earlier, a Buyer's CPA/tax advisor will need to attach Form 3800, taking into account a transferred credit as a current general business credit, the "transfer election statement", and any other information as specified in IRS guidance.

The sponsor (Seller) of the credits is responsible for the tax form evidencing the generation of the credits (i.e., Form 3468 for certain investment tax credits).

Form **3800**
Department of the Treasury
Internal Revenue Service

General Business Credit

Go to *www.irs.gov/Form3800* for instructions and the latest information.
You must include all pages of Form 3800 with your return.

OMB No. 1545-0895
2023
Attachment Sequence No. **22**

Name(s) shown on return | **Identifying number**

A **Corporate Alternative Minimum Tax (CAMT) and Base Erosion Anti-Abuse Tax (BEAT).** Are you both (a) an "applicable corporation" within the meaning of section 59(k)(1) for the CAMT, and (b) an "applicable taxpayer" within the meaning of section 59A(e) for the BEAT? See instructions . . . ☐ Yes ☐ No

Part I **Current Year Credit for Credits Not Allowed Against Tentative Minimum Tax (TMT)**
Go to Part III before Parts I and II. See instructions.

1	Non-passive credits from Part III, line 2: combine column (e) with non-passive amounts from column (g). See instructions	1	
2	Passive credits from Part III, line 2: combine column (f) with passive amounts in column (g). See instructions . . . 2		
3	Enter the applicable passive activity credits allowed for 2023. See instructions	3	
4	Carryforward of general business credit to 2023. See instructions for statement to attach	4	
	Check this box if the carryforward was changed or revised from the original reported amount ☐		
5	Carryback of general business credit from 2024. See instructions	5	
6	Add lines 1, 3, 4, and 5	6	

Part II **Allowable Credit**

7	Regular tax before credits: • Individuals. Enter the sum of the amounts from Form 1040, 1040-SR, or 1040-NR, line 16; and Schedule 2 (Form 1040), line 2. • Corporations. Enter the amount from Form 1120, Schedule J, Part I, line 1; or the applicable line of your return. • Estates and trusts. Enter the sum of the amounts from Form 1041, Schedule G, lines 1a and 1b, plus any Form 8978 amount included on line 1d; or the amount from the applicable line of your return.	7	

Summary

- New tax savings opportunity for clients
- Benefits include:
  - ✓ Cash savings
  - ✓ Sustainability
  - ✓ Recognition in Public Documents/Disclosures

- Risk can be mitigated with due diligence, documentation, and indemnification.

ARMAGH CAPITAL

Armagh Capital's extensive network simplifies the time-consuming process of connecting tax credit sellers with reputable buyers, ensuring a more efficient and valuable outcome.

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