Energy tax provisions – Summary

Inflation Reduction Act signed into law on August 16, 2022

Extensions/modifications to:

- Sec. 45 Production tax credits and Sec. 48 investment tax credits for wind, solar, geothermal, hydropower, etc.
- Sec. 45Q Credit for carbon oxide sequestration (increased rates)
- Sec. 48C Credit for manufacturing energy property including EV components, fuel cells, electric grids, etc.
- Sec. 179D Energy efficient commercial buildings deduction
- Sec. 30D & Sec. 25E for EVs & Sec. 30C charging stations

New credits for:

- Sec. 45U Zero-emission nuclear power production credit
- Sec. 45V Clean hydrogen production credit
- Sec. 45W Qualified commercial clean vehicles
- Sec. 45X Manufacturing credit for solar and wind components, batteries and critical minerals
- Sec. 45Y and 48E Technology neutral clean electricity production and investment credits
- Sec. 45Z Clean fuel production credit

Energy Tax Provisions- New Requirements

Prevailing wage & apprenticeships

- 5 times higher credit rates available for projects which satisfy certain wage and workforce requirements during the construction and operation of the projects (e.g., 6% ITC vs 30% ITC)
- Under transition rule, generally projects that begin construction before January 29, 2023 are eligible for bonus rate even if they don't satisfy the prevailing wage and apprenticeship requirements

Domestic content

- Additional credits available in some cases if projects are constructed using domestically sourced steel and iron, as well as manufactured products

Energy communities

- Additional credit amounts available in some cases for projects located in census tracts where coal mines and coal-fired power have closed, brownfield sites, and communities formerly reliant on coal and fossil fuel industries

Prevailing Wage & Apprenticeships – Proposed Regulations

Proposed regulations – takeaways:

- Documentation burden on taxpayer
- Curing provisions:
    1) Pay the worker the difference between what was actually paid and the prevailing wage. (3 times the amount of shortfall in the case of intentional disregard)
    2) The taxpayer must also pay interest on the shortfall. The rate is the federal short-term rate plus 6%.
    3) Penalty: the taxpayer must pay to the IRS $5,000; In case of intentional disregard, must pay $10,000 per worker
        - Rebuttable presumption against finding intentional disregard if correction and penalty payments made timely
        - Penalty waived altogether if underpayment is small and correction made within 30 days
- Apprenticeship requirement/Good faith effort exception – apprenticeship request must be made every 120 days
- Prevailing wage & apprenticeship requirements apply to certain secondary sites where a significant portion of the construction, alteration, or repair of the facility occurs

Energy Communities – Notice 2023-29

Up to 10% bonus credit available if project located in an energy community:

- Brownfield site
- Coal census tract
- Statistical area that has (1) (or, at any time during the period beginning after December 31, 2009, had) 0.17% or greater direct employment or 25% or greater local tax revenues related to fossil fuels, and (2) has an unemployment rate at or above the national average unemployment rate for the previous year

Timing: Project must be in an energy community yearly for PTC, and for recapture period for ITC

Safe Harbor: Projects that begin construction on or after Jan. 1, 2023:

- PTC: if in an energy community as of the beginning of construction, project is considered in an energy community for the duration of the credit
- ITC: if in energy community as of the placed-in-service date, project considered in an energy community for recapture period

Location: Facilities partially in an energy community must meet one of the following tests

- Nameplate Capacity Test (Default): at least 50% of the project's nameplate capacity is in an energy community
- Footprint Test: at least 50% of square footage in an energy community
- Offshore rule- substation

Domestic Content – Notice 2023-38

- For ITC and PTC projects placed in service after 2022, up to 10% credit available if project constructed using domestic content, specifically:
  - 100% domestically sourced steel and iron
  - A specified percentage of the total costs of the manufactured products, percentage is adjusted per year

Begin construction	% of US manufactured products
Before 2025	40% (20% offshore wind)
In 2025	45% (27.5% offshore wind)
In 2026	50% (35% offshore wind)
In 2027	55% (45% offshore wind)
After 2027	55% (55% offshore wind)

- Must determine whether an applicable project component is steel or iron, or a manufactured project component

- For manufactured products must be able to determine origin and direct costs of components

- Notice provides safe harbor identifying project components as a manufactured component or steel/iron

Low Income Community Allocation

- 10% - 20% Bonus credit applies on top of ITC for wind and solar projects under 5 MW
- Allocation process under which DOE will review application make recommendations to the IRS, which will allocate the bonus credit to 1.8 gigawatts (GW) of eligible solar and wind capacity per year.
- 2023 allocation of capacity will be as follows:

Category 1: Located in a Low-Income Community	700 megawatts
Category 2: Located on Indian Land	200 megawatts
Category 3: Qualified Low-Income Residential Building Project	200 megawatts
Category 4: Qualified Low-Income Economic Benefit Project	700 megawatts

- A 10% increase is available to projects installed in low-income communities or on Indian land. A 20% increase is available to projects that are part of a qualified low-income residential building or provide at least 50% of a facility's total output to qualifying low-income households.
- 2023 allocation round will open this fall

Refresher- beginning of construction

Beginning of construction affects:

- Determining whether prevailing wage and apprenticeship requirements apply
- Energy Community Safe Harbor
- Domestic content applicable percentage and phaseout for direct pay
- Expiration dates for various credits

In general, construction begins when:

- Physical work of a significant nature begins ("Physical Work" test), or
- A taxpayer pays or incurs 5% or more of the total cost of energy property ("5% Safe Harbor")
- Under either Physical Work or the 5% Safe Harbor, requirement for construction to be continuous after it begins
- Under existing guidance work will generally be deemed to be continuous if the project is placed in service by the end of the calendar year that is no later than 4 years (6 years for 45Q) after the calendar year when construction began

Overview of § 48 Investment tax credit (ITC)

One-time investment tax credit (ITC) equal to a percentage of the eligible basis of qualifying energy property placed in service during the taxable year. Energy property includes solar, cogeneration, biogas, energy storage

Eligible basis* ✖ ITC % = ITC

Eligible Basis

- Compute eligible basis based on project costs
- Cost segregation analysis identifies eligible vs. ineligible direct costs
- Generally indirect costs allocated based on direct costs

ITC %

- Base rate
- Prevailing wage & apprenticeship bonus
- Domestic content bonus (or reduction)
- Energy community bonus
- Environmental justice bonus

– 5-year recapture period

– Credit rate reduced if tax-exempt bond financing used

Manufacturing tax credits

Credit	Credit Summary	Considerations
Section 48C - Qualified Advanced Energy Project	Provides ITC equal to 6% or 30% of the investment with respect to any advanced energy project. $10 billion of tax credits to be allocated with $4 billion reserved for projects located in certain energy communities. Available for investments in the following types of projects: 1. Clean energy manufacturing and recycling projects 2. Greenhouse gas emission reduction projects 3. Critical material projects	Allocated credit- have to apply to DOE/IRS; First allocation round occurring now Prevailing wage requirements apply Direct pay only for tax-exempt/government entities; Transferable for taxpaying entities Cannot be placed in service prior to receiving allocation of credit Must generally place project in service within 4 years of receiving allocation of credit
Section 45X - Advanced Manufacturing Production	Provides a production tax credit (PTC) for the production of certain eligible components sold to an unrelated person (exceptions apply). The credit amount varies based on the eligible component, which includes solar components, wind energy components, inverters, qualifying battery components, and critical minerals.	No prevailing wage requirements Direct pay for first 5 years; transferable when not claiming direct pay Available for components produced and sold after 2022; phase-down begins in 2030 and no credit post-2032 (no phase-down for critical minerals)

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Energy tax provisions – Monetization

“Direct pay” options for:

- Section 45Q Carbon Oxide Sequestration Tax Credit,
- Section 45V Clean Hydrogen Production Credit,
- Section 45X Advanced Manufacturing Production Credit
- Tax-exempt entities, states, and political subdivisions thereof

The legislation also allows taxpayers to monetize tax credits by transferring credits to third parties.

- Transfer shall be required to be paid in cash
- Transfer shall not be includible in gross income of the transferor
- Amount paid by the transferee shall not be deductible
- Eligible credits can only be transferred **once**

Energy Tax Provisions- Monetization

Transferability & Refundability – Hot Topics (prior to proposed regs)

- Discount rate
- Risk of recapture
- Substantiation needs
- Ability of partnerships to elect direct pay on behalf of tax-exempt partners
- Eligibility of governmental instrumentalities for direct pay
- Ability to purchase credits under section 6418 and then claim direct pay under section 6417
- Ability to claim partial direct pay
- Timing/ability to expedite refunds under section 6417
- Recapture and indemnification
- Application of section 49 and 469 to transferred credits
- Reasonable cause exception to 20% penalty for excessive payments/credit transfers

Proposed Regulations – Transferability

Highlights/Key observations – sell-side:

- Pre-registration required via IRS portal (not open yet – estimated to be available Fall 2023)
- Cannot transfer just credit “adders”
- Special rules apply to transferor partnerships/S corporations
- Considerations for sellers:
  - Purchase for Fair Market Value
  - Tax Credit Insurance
  - Credit Technology Type and Maturity
  - Depreciation Monetization / "Hybrid" Structures
  - Transaction Costs
  - Tax Credit Elections - ITC vs. PTC
  - Prevailing Wage and Apprenticeship Requirements
  - Tax Credit "Adders"
  - Debt and Financing Considerations
  - Timing of Cash Payment / Liquidity

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Proposed Regulations – Transferability

Highlights/Key observations – buy-side:

- No gross income for discounted credit purchase price
- Transferred credits subject to passive activity rules in hands of transferees
- Paid in cash requirement met if cash payment made generally earlier of due date of transferor or transferee tax return
- Transferee may take into account credits it has purchased, or intends to purchase, when calculating estimated tax payments.
- Transferee taxpayers may carryback eligible credits 3 years and carryforward eligible credits 22 years.
- Liable for recapture as result of cessation of eligible use; but not liable for recapture due to change in ownership of transferor partnership/S corporation Considerations for buyers:
  - Tax credit eligibility, structure, recapture risks
  - Syndication vs. Direct Investment
  - ESG Considerations
  - Creditworthiness of Counterparty and Strength of Indemnity
  - IRS Audit Coordination
  - Tax Credit Insurance
  - Credit Technology Type and Maturity

Proposed Regulations – Transferability

Process/timing:

- An election to transfer is made not later than the due date (including extensions) for the tax return for the taxable year for which the eligible credit is determined; election cannot be made on an amended return or AAR
- Before an election can be made by the transferor and credit claimed by a transferee, the transferor must register the credit property for which the election will be made through an IRS portal
- Transferor taxpayer must prepare and sign under penalties of perjury a "**Transfer Election Statement**," should include info such as: name, address, description of eligible credit, total amount of credit determined, the taxable year of the transferor and the first taxable year in which the credit will be claimed by the transferee, the amounts paid as cash consideration and when paid, registration number
- Transferor must also provide transferee with: (i) information that validates the existence of the eligible credit property (which could be third party provided); (ii) as applicable documentation substantiating eligibility for bonus credit amounts; (iii) evidence of credit eligible costs or amount of qualifying production activities
- A transferred credit is taken into account by the transferee in the first taxable year of the transferee taxpayer ending with, or after, the taxable year of the transferor taxpayer with respect to which the credit was determined; allowed to claim transferred credit on amended return
- Transferee taxpayers must report registration number on tax return in connection with claiming transferred tax return, also must attach Transfer Election Statement

Proposed Regulations – Direct Pay

Highlights/Key Observations:

- Pre-registration of credit property through IRS portal required
- Clarifies that government instrumentalities and agencies are applicable entities
- Clarifies that partnerships with one or more tax exempt partners are not considered applicable entities (other than as electing taxpayers for purposes of sections 45Q, 45V and 45X)
  - Exception for partnerships that validly elect out of Subchapter K
- Taxpayers first compute taxable income and then compute the amount of taxable income that may be offset by general business credits (generally 75%), and then must apply general business credits (including direct pay credits) against tax liability first. The net amount of the direct pay tax credit is available as a refund.
- No direct pay election can be made by:
  - Any transferee/purchaser of credits pursuant to section 6418
  - Any lessee of investment credit property that is otherwise allowed to claim the credit pursuant to a lease-passthrough election; or
  - Any disposer or user of carbon oxide that is otherwise allowed to claim section 45Q credits pursuant to a section 45Q(f)(3) election.

Published guidance/Anticipated guidance timeline

Published Guidance

- 30D proposed regulations
- Prevailing Wage notice
- Energy Community notice
- Domestic Content notice
- 48C notice
- 6417/6418 proposed regulations
- Low income community adder proposed regulations and Rev. Proc.
- Prevailing wage and apprenticeship proposed regulations

2023 Q4

- Hydrogen (45V) proposed regulations
- Energy Community proposed regulations
- Domestic Content proposed regulations
- Investment tax credit proposed regulations (updated)
- Advanced manufacturing production credit (45X) guidance
- Section 40B guidance

2024 and beyond

- Credit for carbon oxide sequestration (45Q)
- Commercial clean EVs (45W)
- Section 45L energy efficient homes
- Section 30C charging stations
- Section 179D commercial clean building deduction
- Clean electricity investment and production tax credits (45Y & 48E)
- Clean fuels production tax credit (45Z)
- Nuclear PTC (45U)
- Finalization of regulations