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AN UPDATE ON BUYING AND SELLING CLEAN ENERGY TAX CREDITS

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Agenda

01 **Overview of Saleable Clean Energy Tax Credits**

Summary of the Tax Credit-related Changes in the Inflation Reduction Act of 2022 (“IRA”)

Menu of Credits Available for Purchase From Developers

02 **How to Buy and Sell Credits**

Highlights of Recent IRS Guidance on How to Buy and Sell Clean Energy Tax Credits

Practical Issues for Buyers and Sellers of Tax Credits

Where to Buy Credits

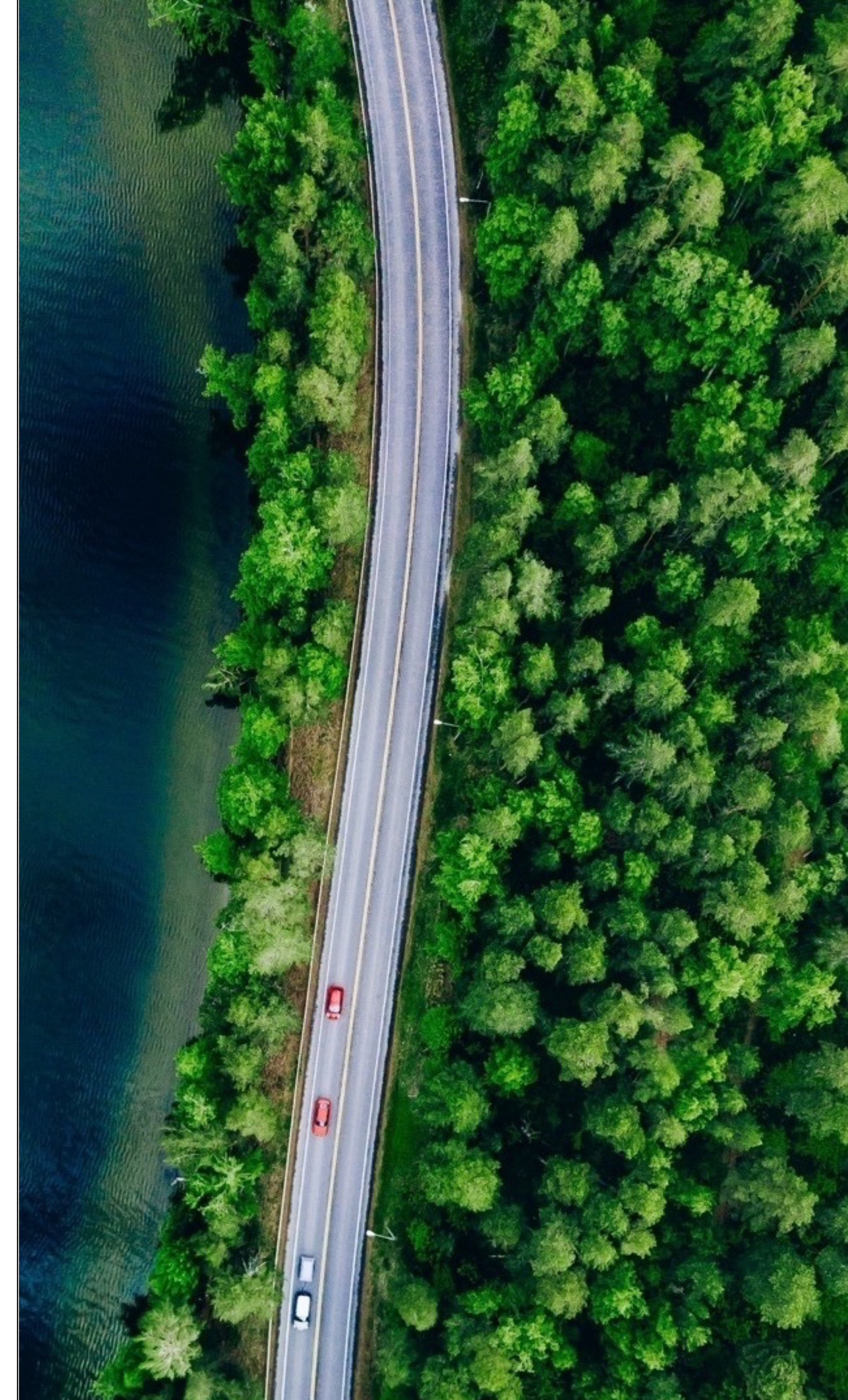
03 **Questions?**

OVERVIEW OF SALEABLE CLEAN ENERGY TAX CREDITS

01

Summary of the IRA’s Clean Energy Tax Provisions

- **Extension, Expansion and Evolution of Legacy Tax Incentives.** The production tax credit (“PTC”), investment tax credit (“ITC”), and carbon capture and sequestration credits were extended and expanded substantially.
  - New substantive requirements (such as prevailing wage and apprenticeship requirements) were introduced that generally must be met to qualify for full credit value.
  - “Bonus” credits were added for projects that meet special manufacturing or geographic criteria (e.g., domestic content, energy community and low income community bonuses).
- **Introduction of New Credits.** The IRA introduced new tax credits (e.g., advanced manufacturing production credits, clean fuel production credits and clean hydrogen production credits) and made certain existing technologies eligible for legacy credits (such as standalone energy storage facilities, biogas facilities and electrochromic glass).
- **Monetization of Tax Credits.** The IRA also authorized certain credits to be sold for cash and introduced a limited “direct pay” program for certain credits.



Wind

- **Tax Credits for Wind Projects.** Extension of legacy PTC and ITC.
  - The new PTC and ITC rates are 100% of the maximum credit rate that was available under prior law (i.e., the pre-phasedown/pre-2017 base rate).
  - Wind projects that begin construction after 2024 will need to satisfy to a zero greenhouse gas ("GG") emission test under a new tech-neutral PTC/ITC regime (subject to a 4-year phaseout beginning in the later of 2033 or the year after a 25% GG reduction target is met (with 2022 as the base year)).
- **Prevailing Wage and Apprenticeship Requirements.** Availability of the maximum credit rate is conditioned on a project meeting "prevailing wage" and "apprenticeship" requirements.
  - Uncured failures to satisfy these requirements could trigger an 80% haircut to the credit amount.
  - Exception for certain projects, e.g. projects that "began construction" before January 29, 2023.
- **Credit Enhancements.** "Bonus" credits are available for facilities located in "energy communities" or that contain a specified amount of domestically produced components.
  - Extra 10-20% ITC (allocated by IRS) for small projects in certain low-income communities.

Solar

- **Tax Credits for Solar Projects.** Extension of legacy ITC and reintroduction of a solar PTC.
  - The ITC rate reverts to 30% and the PTC rate is the same as for wind facilities, in each case subject to satisfying certain requirements (noted below).
  - Solar projects that begin construction after 2024 will need to satisfy same GG emission tests as wind projects under the same tech-neutral regime (with the same phaseout timeline).
- **Prevailing Wage and Apprenticeship Requirements.** Same as for wind projects.
- **Credit Enhancements.** Same as for wind projects.

Energy Storage

- **ITC for Energy Storage Technologies.** ITC eligible property now includes standalone energy storage property (but no extension to energy transmission property).
  - Under pre-IRA law, storage facilities only could qualify if charged by, and part of, an ITC-eligible energy generation facility. (Installation timing and co-location rules were also uncertain.)
  - Apparent drafting glitch in the IRA casts current doubt on the ability to claim ITC on energy storage property that is co-located with a generating facility where PTCs are being claimed, although projects of this type are moving forward in the market.
- **Prevailing Wage and Apprenticeship Requirements.** Same as wind and solar projects.
- **Credit Enhancements.** Same as wind and solar projects (subject to co-installation requirement for low-income communities bonus credit).

Sustainable Aviation Fuel (SAF)

- **New SAF Production Credits.** Eligible SAF must meet statutory fuel and sustainability requirements and be produced in the U.S. (including possessions for 2025-2027 credits).
  - Producer must be registered with IRS and compliance must be verified by an unrelated party.
- **Refundable Excise Tax Credit for 2023-2024.** $1.25/gallon for SAF produced (and sold or used in a qualified mixture), plus $0.50/gallon bonus for SAF exceeding GG emission reduction thresholds.
  - Alternatively, can take a nonrefundable income tax credit (which must be reported as income).
  - Aircraft fueling must occur in the U.S.
- **Transferable Income Tax Credit for 2025-2027.** Up to $1.75/gallon (before inflation adjustment) for SAF produced and sold to unrelated persons (for use in production of a mixture or in a trade or business, or to sellers who engage in specified retail sales).
  - Credit rate based on CO_2e/mmBTU (must be no greater than 50kg CO_2e/mmBTU).
- **Prevailing Wage and Apprenticeship Requirements.** Begin in 2025; akin to wind and solar.
- **Stacking:** No claiming 2025-2027 SAF credits at a facility for which either CCUS credits or hydrogen credits (both discussed below) are being claimed.

Nuclear

- **Tax Credits for Certain Nuclear Power Facilities.** The IRA introduced a production tax credit for electricity produced by certain legacy nuclear power facilities.
  - Only those facilities that were placed in service before the enactment of the IRA (other than “advanced nuclear facilities” placed in service after August 8, 2005 and before 2021).
  - Qualifying facilities are eligible for this credit through 2032.
  - The calculation of the precise amount of the credit remains subject to significant uncertainty pending further guidance from the IRS and Treasury.
- **Tech-Neutral Credit.** Nuclear facilities on which construction begins after 2024 potentially eligible for tax credits under the tech-neutral PTC/ITC regime, subject to meeting the GG emission tests that apply to that tech-neutral regime.
- **Prevailing Wage Requirements.** Akin to solar, wind and storage (solely for alteration and repair work).
  - No “apprenticeship” requirements.

Other New Clean Technology Credits

- **Other Technologies Now Eligible (or Eligible Again) for ITC/PTC.**
  - Geothermal
  - Electrochromic Glass (“smart” or “dynamic” glass) (for projects that begin construction before 2025)
  - Biogas (for projects that begin construction before 2025)
  - “Technology Neutral” Regime after 2024
- **Other New Credits.**
  - Other Renewable and Clean Fuels
  - Clean Vehicle Credit
  - Qualified Commercial Clean Vehicles Credit

Carbon Capture and Sequestration ("CCUS")

- **Direct Pay.** Eligible for "direct pay" for first five years of 12-year credit period.
- **Enhancement of Credit Rates.** Under the IRA, credit rates were increased to:
  - $85/metric ton for carbon oxides that are sequestered but not utilized.
  - $60/metric ton for carbon oxides that are sequestered through an enhanced oil recovery process or that otherwise are utilized in an industrial process.
  - Annual inflation adjustment to rates starting in 2027.
  - Significantly higher rates for direct air capture.
- **Capture Requirements.** The IRA materially reduced threshold carbon capture requirements:
  - For an electricity generating facility emitter, the facility must capture no less than 18,750 annual metric tons (as well as have a capture design capacity of at least 75% of the baseline carbon oxide production of the facility).
  - For most other emitters, the facility must capture no less than 12,500 annual metric tons.
- **Prevailing Wage and Apprenticeship Requirements. Generally same as wind and solar.**
- **Stacking.** No claiming 2025-2027 SAF credits or new clean hydrogen production credits (discussed below) at a "facility" for which CCUS credits are being claimed.

Hydrogen

- **Direct Pay.** Eligible for “direct pay” for first five years of 10-year credit period.
- **New H2 Tax Credits.** The IRA introduced a 10-year production tax credit for clean hydrogen or (at the taxpayer’s option) an ITC in respect of a facility that produces clean hydrogen.
  - The production tax credit ranges from $0.60/kilogram to $3/kilogram based on lifecycle GG rate.
  - The ITC rate also varies based on same lifecycle GG rate scale (with same maximum base rate as wind and solar projects).
  - Hydrogen must be produced (i) in the United States (or certain U.S. possessions), (ii) in the ordinary course of a trade or business, and (iii) for sale or use.
  - Emissions accounting standards are subject to significant debate pending regulatory guidance.
- **Prevailing Wage and Apprenticeship Requirements.** Same as wind, solar and CCUS projects.
- **Stacking.** In addition to hydrogen production credits, credits are also expected to be available for energy-generating assets used to produce clean hydrogen, hydrogen energy storage property, and qualifying fuel cell power plants.
  - No claiming 2025-2027 SAF credits or CCUS credits at a “facility” for which hydrogen production credits are being claimed.

Advanced Manufacturing Production

- **Direct Pay.** Eligible for “direct pay” for any one five-consecutive-year period during the credit term (see below).
- **New Advanced Manufacturing Production Credit.** The IRA introduced a tax credit for the production of components employed in certain clean energy technologies (wind, solar, storage, etc.), including critical minerals.
  - These components must be (i) produced in the United States (or certain U.S. possessions) and (ii) sold (in a trade or business) to a person unrelated to the taxpayer.
  - The amount of the credit varies depending on the type of technology.
  - The credit for critical mineral production is equal to 10% of the costs “incurred by the taxpayer with respect to the production of the applicable mineral.”
  - The meaning of “produced” is subject to uncertainty pending regulatory guidance.
- **Credit Term.** The credit will generally phase-down 25% per year starting in 2030.
  - The credit for the production of critical minerals will not phase down.

HOW TO BUY AND SELL CREDITS

02

Who Can Sell Credits

- **Eligible Taxpayer.** Seller must be an "eligible taxpayer."
  - This includes most U.S. taxpayers, including passthrough entities.
  - Owners of passthrough entities are not eligible to sell credits allocated by the passthrough entity.
  - Excludes certain tax-exempt entities that are broadly eligible for direct pay (but such entities can sell credits indirectly via passthrough entities, subject to rules that may reduce the credits available to the passthrough entity).

- **Ownership Requirement.** Credit seller must own the credit generating property.
  - Credits otherwise allowed under special rules to, e.g., lessees or CO2 sequesterers/users cannot be sold.

- **No Resales.** A credit buyer cannot re-sell credits it has purchased.
  - Generally prevents emergence of dealers or clearinghouses, but permits brokers.
  - Allocation of credit from a passthrough entity to its owners is not a prohibited re-transfer.

Who Can Buy Credits

- **Most Likely.** Taxable C corporations.
  - Generally should be able to offset taxable income with credits.
  - IRA credits can wholly offset the new corporate alternative minimum tax (CAMT).
- **Least Likely.** Individuals, trusts, and estates.
  - Passive activity credit rules prevent credits from offsetting wage or portfolio investment income.
  - Credits will be attributable to a trade or business but buyers will not, by virtue of their purchase, be considered to materially participate in such business.

How Are Credits Portioned Out For Purchase and Sale

- **Sold “property”-by-“property” and “facility”-by-“facility.”**
  - For example: 1 rooftop solar project = 1 property, and 1 wind tower = 1 facility.
  - Significant flexibility, but also significant compliance (e.g., separate transfer election generally required for each property or facility).
  - ITCs, however, can be grouped and sold on a “project” basis (upon seller’s election).
- **Portions.** Sellers can sell credits in portions (e.g., $50 out of $100 expected ITC for a project).
- **Portion sizes:** Horizontal, but Healthiest.
  - No separate sales of “bonus” credits apart from each other or from the base credit.
  - Seller-retained portion of credits (if any) are disallowed before Buyer-purchased portion of the credit.
  - Example: Property expected to generate $100 of ITC. Seller claims $50 of ITC and sells $50 of ITC to Buyer. In a later year it is determined that the property only generated $50 of ITC. Seller’s retained $50 ITC is disallowed; Buyer is unaffected.

When Buyers Can Use Purchased Credits

- **If Buyer and Seller Have the Same Taxable Year:** Buyer takes the credit into account in the year of the purchase.

- **If Buyer and Seller Have Different Taxable Years:** Buyer takes the credit into account in Buyer’s first taxable year that ends after Seller’s taxable year in which the credit was determined.
  - Example: If Buyer is calendar-year taxpayer and Seller has an 11/30 taxable year, and Seller sells to Buyer a portion of an ITC that was determined on 12/15/23, Buyer takes the credit into account for its taxable year ending 12/31/24.

- **Buyer Can Apply Purchased Credits Against Estimated Payments.**
  - Buyer may take into account credits that it has purchased or intends to purchase.

What Can Credit Buyers Pay and When

- **Cash only.** Purchases must be made in "cash."
  - Non-cash consideration "in connection with the transfer" may void the entire credit sale.
- **Must Be Paid in Regulatory Window.**
  - Not before first day of Seller's taxable year in which the credit is determined.
  - Not after the first to occur of the timely filing of Buyer's or Seller's tax return (including extensions).
  - Forward contracts are permitted so long as payments are made within the regulatory window.
  - Payments outside the regulatory window void the entire credit sale.
  - Regulatory window constraint tends to favor the ITC (up-front credit) over the PTC (multi-year credit).
- **No Late Seller Elections.** No relief (of any kind) for late elections by Sellers, but Buyers can report purchased credits on amended returns.

How Buyers and Sellers of Credits Are Taxed

- **Seller:** Payments received "in connection with" credit sales are not includible in gross income.

- **Buyer:** Payments made "in connection with" credit sales are not deductible.
  - Buying credits at a discount and applying such credits against tax does not create income.
  - Example: Seller sells $100 ITC to Buyer for $90. Buyer does not have gross income of $10 when it applies $100 purchased ITC to reduce its tax liabilities by $100.

- **Cash Payments Must Be "In Connection With" Credit Transfers.** Payments must be "directly related" to the credit and not related to an excessive credit transfer (discussed below).
  - Adjacent transactions must be carefully scrutinized to ensure (under an "a principal purpose" standard) that no adjacent transactions are being compensated via a disguised exempt credit sale income, or are expenditures representing disguised non-deductible credit sale expenses.
  - Example: Seller generates $100 ITC and also provides services to customers. Seller offers Buyer the opportunity to purchase $100 ITC for $100 while receiving Seller's services for free. Seller normally charges $20 for the same services without the purchase of the ITC, and the average transfer price of the ITC between unrelated parties is $80 paid in cash for $100 ITC. Seller will be treated as transferring $100 ITC for $80, and have $20 of gross income from the services provided to Buyer.

How to Complete a Credit Sale (Administratively)

- **Seller Pre-Sale Registration.** Sellers must receive a registration number from the IRS, each year, for each property or facility with respect to which a sale election is made.
  - Registration numbers are sought through an IRS electronic portal and issued after IRS review.
  - Narrow definition of property/facility could require many numbers for a single project.
- **Seller IRS Statement.** Seller must timely file with its original tax return (including extensions) a written document, signed under penalties of perjury by Seller, that includes specified regulatory attestations and information (including the registration number for the property or facility).
  - IRS statement could be the parties' credit sale agreement.
  - Seller must certify to the IRS that Seller provided Buyer the "required minimum documentation" substantiating the credit (which Buyer must retain for reporting and audit purposes).
- **Buyer Consent.** Buyer must provide written consent to Seller's statement and file with Buyer's return.
- **Other Forms.**
  - Seller must include all other IRS filings required to report the credit amount, including a schedule showing the portion of the credit sold for each property or facility.
  - Buyer must report the registration number and the portion of credit purchased on IRS Form 3800.

How to Avoid Excessive Credit Transfer Penalties

- **Excessive Credit Transfer Penalty.** Buyer will incur a 20% penalty (plus forfeiture, in whole or in part) if Buyer claims "excessive" purchased credits without reasonable cause.
  - Credits are excessive if they are in excess of the amount the IRS finds were properly determinable with respect to Seller.
  - Buyer may seek to require Seller to sell less than all expected credits to minimize risk.
  - Buyer's payments for "excessive" credit amounts are income to Seller.
- **"Reasonable Cause"** will be determined based on the relevant facts and circumstances.
  - Most significant factor is Buyer's efforts to determine that the amount of the purchased credit is not excessive and has not been sold to another taxpayer.
  - Evidenced by relying on Seller's records, third-party expert reports and representations.
  - "Reasonable cause" eliminates 20% penalty, but any "excess credit" is still forfeited.

Who Is Subject to Recapture

- **Buyer Bears Recapture Risk (with One Exception).**
  - Background: Certain credits are subject to recapture (e.g., ITC vests over a 5-year period) upon certain events after the credits are otherwise properly determined.
  - Buyer generally bears recapture risk (including recapture triggered by Seller's disposition of the property or facility), but Buyer can contract for indemnities or insurance regarding recapture.
- **Certain Recapture Events Triggered by Passthrough Entity Sellers.**
  - If recapture is triggered by the disposition by a partner or S corporation shareholder of its interest in the applicable passthrough-entity Seller, recapture is imposed on the disposing partner or shareholder (not Buyer), as long as the recapture event is not as a result of the identity of the transferee (e.g., as a result of the partnership's property becoming tax-exempt use property).

How the Rules Apply to Passthrough Entities

- **Who Transfers Credits.**
  - Passthrough entities (i.e., partnerships and S corporations) that own the property or facility must sell the credits, i.e., partners and shareholders in a passthrough-entity seller are not permitted to sell credits that are allocated to them.

- **How Do Partner- and Shareholder-Level Limitations Apply.**
  - Passthrough-entity sellers are required to apply the “at-risk” rules of section 49 based on how those rules would apply to the passthrough entities’ partners or shareholders, adding potentially significant complexity.
  - Passthrough-entity sellers are not limited by the passive activity credit rules.
  - Tax-exempt use property limitations will continue to apply to partnership sellers and may reduce the amount of certain credits (e.g., ITC) that can be sold by partnerships with tax-exempt partners.

- **How Do Partnership Sellers Allocate Tax-Free Sale Income.** Based on how the underlying credit would have been allocated in the absence of a sale, allowing for substantial flexibility.

- **How Do Partnership Buyers Allocate Credits.** Treated as “extraordinary items” and allocated upon purchase in proportion to the allocation of the nondeductible expenses funding the purchase.

Practical Issues For Sellers and Buyers

- **Luring New Buyers.** Tax equity is historically complex and markets were effectively at capacity; structures likely need to be simple and easily communicable to attract entrants.

- **Contractual Indemnities.** Developers are riskier counterparties compared to Buyer's risk-free alternative (paying their taxes). Diversified funds may help alleviate such risk.

- **Tax Insurance.** Anticipated to play a critical role. Tax credit sellers are expected to bear, directly or indirectly, cost/expense as an economic matter.

- **Buyer diligence.** Avoiding excessive transfer payment penalties, meeting required minimum documentation requirements, and securing tax insurance will require significant buy-side diligence, creating opportunities for aggregators who will form tax credit buyer partnerships.
  - Buyers will need to contractually protect themselves against recapture risk.

- **Bridge financing.** Rules effectively preventing pre-payments will necessitate additional bridge financing arrangements for developers.

- **Uncertain or severe rules.** Vague rules and foot-faults that can wholly void sales (non-cash payments; late filings; early payments) introduce execution risk that may weigh on net proceeds.

Where to Buy and Sell Credits

1

Direct Sales

Already under way. Call your friends.

2

Brokered Sales

Developing business. Stay tuned.

3

Third-Way?

Structures currently under consideration to attract new entrants.

QUESTIONS?

03

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