

Summary of Treasury's Guidance on Elective Pay and Transferability

Background

On June 14, 2023 the IRS [announced](#) a pair of proposed rules articulating guidance on how certain tax credits created or modified by the Inflation Reduction Act (IRA) will be implemented. Specifically, the proposals discuss [how these tax credits can be utilized by eligible entities](#) and [how the benefits can be transferred between eligible entities](#). The IRS is accepting public comments on both proposals through August 14, 2023.

Elective Pay

Elective pay, commonly referred to as direct pay, is a novel tax credit delivery structure created through the Inflation Reduction Act. For the first time, government entities that do not owe federal income taxes will be able to receive a payment equal to the full value of relevant tax credits for building qualifying clean energy projects or making qualified investments. Through elective pay, eligible entities can notify the IRS of their intent to claim a direct payment for the full value of the credit on their tax return. Touted as a game changer for climate innovation, elective pay acts as a force multiplier and is intended to allow small businesses, governments, nonprofits, and start-ups to help catalyze the impact of the IRA.

Applicable credits:

The IRA allows tax-exempt and governmental entities to receive elective payments for 12 clean energy tax credits, including the major Investment and Production Tax credits, as well as tax credits for electric vehicles and charging stations. Applicable entities are listed below.

- §30C Alternative fuel vehicle refueling property credit
- §45 Renewable electricity production credit
- §45Q Carbon oxide sequestration*
- §45U Zero-emission nuclear power production credit
- §45V Clean hydrogen production credit*
- §45W Qualified commercial vehicles
- §45X Advanced manufacturing production credit*
- §45Y Clean electricity production credit
- §45Z Clean fuel production credit
- §48 Energy credit
- §48C Qualified advanced energy project credit
- §48E Clean electricity investment credit

*Businesses can also choose elective pay for three of the credits: Carbon Oxide Sequestration (45Q), Clean Hydrogen (45V), and Advanced Manufacturing (45X).

Applicable entities for elective pay:

- Tax-exempt organizations under 501(a), including 501(c) and 501(d) organizations
- State and political subdivisions such as local governments

- Indian tribal governments
- The U.S. territory governments and political subdivisions
- Agencies and instrumentalities of the state, logical, tribal, and territorial governments
- Alaska Native Corporations
- The Tennessee Valley Authority
- Rural electric cooperatives

Bonuses

The domestic content bonus results in a 2% increase for Production Tax Credit facilities and a 2-point bonus for Investment Tax Credit facilities. For projects or facilities beginning construction starting in 2024, not meeting the domestic content requirement can result in a reduction in the credit earned.

The domestic content bonus consists of two parts:

- Steel and Iron Requirement, which requires that products that are primarily steel and iron must be 100% made in the U.S.
- Manufactured Product Requirement, which is satisfied if all component "manufactured products" are produced in the U.S. or are deemed to be produced in the United States.
 - A manufactured product is considered to be produced in the U.S. if:
 - all of the manufacturing processes for the product occurred in the U.S.; and
 - all of its components (manufactured product components) are of U.S. origin, regardless of the origin of its subcomponents.
 - A manufactured product is deemed to be produced in the U.S. if the project meets or exceeds the domestic manufacturing percentages (further determined as all domestic manufactured products and domestic component costs divided by the total manufactured product costs):
 - 40% for projects beginning construction before 2025
 - 45% for projects beginning construction in 2025
 - 50% for projects beginning construction in 2026
 - 55% for projects beginning construction thereafter.

The prevailing wage and apprenticeship requirements, if met, can increase the credit amount fivefold (to 10%).

These requirements demands that:

- employers pay Davis-Bacon Act prevailing wages to workers on applicable projects, and
- employers use registered apprentices.

The prevailing wage requirement applies to the Zero-Emission Nuclear Power Production Credit. The prevailing wage *and* apprenticeship requirements apply to the:

- §30C Alternative Fuel Refueling Property Credit
- Production Tax Credit
- §45Q Credit for Carbon Oxide Sequestration

- Credit for Production of Clean Hydrogen
- §45Z Clean Fuel Production Credit
- Investment Tax Credit
- §48C Advanced Energy Project Credit
- Energy Efficient Commercial Buildings Deduction

Special Rule: Grants and Loans

The proposed guidance also includes a special rule that would enable entities to combine forgivable loans with tax credits.

If a qualifying purchase is funded by a tax-free grant or forgivable loan, entities would get the same value of the eligible tax credit as if the investment was financed with taxable funds. This occurs only if the combined cost of the credit plus restricted tax-exempt amount is less than or equal to the cost of the investment and applies only to investment-related credit property described in sections 30C, 45W, 48, 48C, or 48E.

Example A:

- A school district receives a \$300,000 tax-exempt grant to purchase an electric school bus. Under IRA, clean commercial vehicles are eligible for a tax credit of up to \$40,000.
- The school district purchases the bus for \$400,000, using the entire grant amount and \$100,000 of the district's unrestricted funds.
- The school district's basis (amount of the capital investment in the property for tax purposes) for the electric bus is \$400,000 and the school district's section 45W credit is \$40,000.
- Since the total amount of the assistance (\$340,000) is less than the investment (full cost of the electric bus), the school district's 45W credit is not reduced.
 - Total assistance: \$300,000 (grant) + \$40,000 (45W credit) = \$340,000
 - Total investment amount = \$400,000
 - \$340,000 (assistance) ≤ \$400,000 (investment cost)

Example B:

- A school district receives a \$400,000 tax-exempt grant to purchase an electric school bus. The same rules apply; the school district qualifies for the maximum section 45W credit of \$40,000.
- The school district purchases the school bus for \$400,000.
- Since the total amount of the assistance (\$440,000) exceeds the investment (\$400,000), the school district's 45W credit is reduced by the amount necessary so that the total amount of the assistance equals the amount of the investment.
 - Therefore, the \$40,000 section 45W credit is reduced to \$0.

Transferability

Tax credit-eligible entities who are not eligible for elective pay can transfer all or a portion of the credit to a third-party buyer in exchange for cash. The buyer and seller would negotiate and agree to the terms and pricing.

IRA allows businesses not using elective pay to transfer all or a portion of any of the qualifying eleven clean energy credits to a third-party in exchange for tax-free immediate funds so that businesses can take advantage of tax incentives if they do not have sufficient tax liability to fully utilize the credits themselves. Entities without sufficient tax liability were previously unable to realize the full value of credits, which raised costs and created challenges for financing projects.

Any taxpayer that is NOT an applicable entity under elective pay can transfer (sell) all or a portion of the following eleven "eligible credits":

- §30C Alt. Fuel Vehicle Refueling/Recharging Property Credit (Part 8911, Part II)
- §45 Renewable Electricity Production Credit (Form 8835, Part II)
- §45Q Carbon Oxide Sequestration Credit (Form 8933)
- §45U Zero-emission Nuclear Power Production Credit (Form 7213, Part II)
- §45V Clean Hydrogen Production Credit (Form 7210)
- §45X Advanced Manufacturing Production Credit (Form 7207)
- §45Y Clean Electricity Production Credit
- §45Z Clean Fuel Production Credit
- §48 Energy Credit (Form 3468, Part VI)
- §48C Qualified Advanced Energy Project Credit (Form 3468, Part III)
- §48E Clean Electricity Investment Credit (Form 3468, Part V)

A taxpayer can transfer all or a portion of an eligible credit generated from a single eligible credit property, but cannot transfer a portion that is directly related solely to a bonus credit amount. For example, a tax credit portion related to the Domestic Content Bonus cannot be transferred separately from the rest of the eligible tax credit. Likewise, eligible taxpayers may also sell an eligible credit generated from a single eligible credit property to multiple unrelated parties in the same tax year.

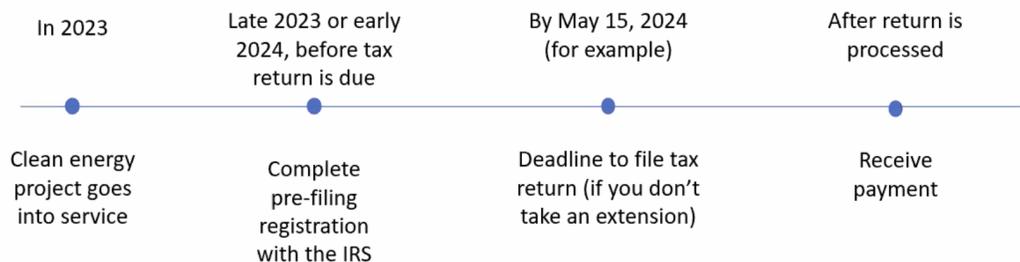
The amount of eligible credits a taxpayer can transfer can be affected by bonus or other requirements that may apply (including the Prevailing Wage and Apprenticeship Requirements, Domestic Content Bonus, the Energy Communities Bonus, and the Low-Income Communities Bonus).

An eligible tax credit can only be transferred in exchange for cash, and transferability does not allow depreciation benefits to be transferred.

Example Timeline: Local Government Project Placed Into Service in 2023

A local government that makes a clean energy investment that qualifies for the investment tax credit can file an annual tax return (via Form 990-T) with the IRS to claim elective pay for the full value of the investment tax credit, as long as it meets all of the requirements, including a pre-filing registration requirement.

As the local government would not owe other federal income tax, the IRS would then make a refund payment in the amount of the credit to the local government.



To transfer eligible credits, an entity must:

1. Pursue a project that generates one of the eligible credits.
2. Complete electronic pre-filing registration with the IRS in sufficient time to have a valid registration number at the time the entity files its tax return. More information about this pre-filing registration process will be available by late 2023.
3. Satisfy all requirements necessary to earn the eligible credit for the tax year. For example, a solar energy project would need to be placed in service prior to earning an eligible credit.
4. Arrange to transfer an eligible tax credit to an unrelated party in exchange for only cash.
5. Provide the transferee (i.e., buyer) with the registration number and all other information necessary to claim the transferred eligible credit.
6. Complete a transfer election statement with the transferee.
7. File a tax return for the taxable year in which the eligible tax credit is determined, indicating the eligible credit has been transferred to a third party. Include the transfer election statement and other information as required by guidance. The tax return must include the registration number for the relevant eligible credit property and must be filed no later than the due date (including extensions) for such tax return.

Separate registration numbers are required for each facility, but transferors provide the same registration number to all transferees of an eligible tax credit generated by the same eligible credit property.

8. If applicable, renew pre-filing registrations and file returns for each subsequent year that a transfer election is made to transfer an eligible credit related to the eligible credit property.

To purchase eligible credits and claim transferred eligible credits, an entity must:

1. Arrange to purchase an eligible credit from an unrelated party in exchange for only cash.
2. Obtain from the transferor the registration number of the eligible credit property generating the eligible credit and all other information necessary to claim the eligible credit transferred.
3. Complete a transfer election statement with the transferor.
4. File a tax return for the taxable year in which the eligible credit is taken into account by the transferee under the rules of section 6418 and include the transfer election statement and other information as required by guidance. The tax return must include the registration number for the relevant eligible credit property.

The transferee and transferor may file their tax returns in any order.

Transfer election statements

A transfer election statement should be attached to the transferor's tax return for the year in which the transferor becomes entitled to the eligible credit.

The transfer election statement should be attached to the transferee's tax return for the year in which the transferee takes the eligible credit into account.

The statement generally includes:

- name, address and taxpayer identification number for both the transferor and transferee,
- a description of the type and amount of the eligible tax credit transferred,
- the timing and amount of cash paid for the eligible tax credit transferred,
- the registration number related to the eligible credit property, and
- certain statements and/or representations from the transferor and transferee as described in the guidance.

Special circumstances

For transferred eligible credits under sections 48, 48E or 48C or transferred carbon sequestration tax credits under section 45Q, the transferee bears the financial responsibility for a recapture event and is required to recapture an amount of previously claimed tax credits based on the timing and amount of the recapture event. The transferor is required to notify the transferee if a recapture event occurs. For other eligible credits, recapture is not relevant.