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New Ways to Finance Your Renewable Energy Projects Thanks to the U.S. Government: Procopio

Two forthcoming changes to U.S. law have the potential to significantly change how renewable energy projects are financed. Both changes are part of the Inflation Reduction Act signed into law by President Joe Biden on August 11, 2022, which along with provisions for business taxes, health care and Internal Revenue Service enforcement efforts contains incentive programs to combat climate change.

Specifically, the new law monetizes renewable energy credits through the *direct pay election* (under new Internal Revenue Code ("Code") §6417) and the *credit transfer election* (under new Code §6418). Both elections are effective for tax years beginning after December 31, 2022.

Let's look at each, one at a time.

Direct Pay Election
The direct pay election was predominantly designed to provide the below-listed refundable tax credits to tax-exempt entities, state and local governments and political subdivisions, the Tennessee Valley Authority, tribal governments, Alaska Native Corporations, and cooperatives that furnish electricity to rural areas (the forgoing collectively referred to as "Tax-Exempt Entities"). New Code §6417 also provides a narrow allowance for refundable tax credits to taxable partnerships and S corporations in respect to the clean hydrogen production credit, the carbon capture credit, and the advanced manufacturing credit.

In spite of the fact Tax-Exempt Entities do not typically pay tax under the Code, new Code §6417 treats Tax-Exempt Entities as having made tax payments equal to the amount of the credits listed below. Whether paid by taxable entities or deemed paid by Tax-Exempt Entities, new Code §6417 treats the payments of tax or deemed payments of tax as having been made as of the later of the date of filing, the due date of the entity's tax return or the date a return would be due if required in the case of Tax-Exempt Entities that are government entities that do not file tax returns. Entities that make the election can then claim a refund of the excess taxes paid or deemed paid. The direct pay election applies to the following renewable energy credits:

- So much of the credit for alternative fuel vehicle refueling property as is treated as a business credit under Code § 38;
- So much of the credit for renewable electricity production attributable to qualified facilities originally placed in service after December 31, 2022;
- So much of the carbon oxide sequestration credit attributable to carbon capture equipment originally placed in service after December 31, 2022;
- The zero-emission nuclear power production credit;
- So much of the credit for clean hydrogen production credit attributable to qualified clean hydrogen facilities originally placed in service after December 31, 2012;
- For the U.S., states and political subdivisions, U.S. possessions, tax-exempt organizations other than cooperatives under Code §521, and tribal governments, the credit for qualified commercial

clean vehicles determined under Code §45W(d)(3);
- The credit for advanced manufacturing production;
- The credit for clean electricity production;
- The credit for clean fuel production;
- The credit for energy investment determined under Code §48;
- The credit for qualifying advanced energy project investment; and
- The credit for clean electricity investment determined under Code §48E.

Credit Transfer Election

All taxpayers, *excluding* Tax-Exempt Entities, may transfer all or a portion of their eligible credits to an unrelated taxpayer (again, excluding Tax-Exempt entities). Eligible credits include all credits listed above minus the credit for qualified commercial clean vehicles. The transfer consideration must be paid in cash, is not deductible to the transferee nor includible in the income of the transferor.

After the transfer, the transferee will be treated as the taxpayer entitled to the credit for all purposes under the Code. Applicable credits belong to a partnership, not its partners, which means the partnership must elect to transfer the credits.

The Monetization Impact on Project Funding

Both of the above options have the potential to change the financing models of renewable energy projects.

- The direct pay option allows pension funds, universities, municipalities, and investment funds with such tax-exempt investors to make direct investments in renewable energy products under certain conditions.
- The credit transfer provision expands the pool of available investors for renewable energy projects by allowing project developers to monetize applicable credits through third party sales without requiring those third-party transferees to be directly involved in the project, thereby mitigating development, construction and operational risks for the transferee assuming the transfer is properly negotiated and documented.

Both the direct pay and transfer elections will require planning as related to the amount of cash received and the timing of receipt. The direct pay option requires alternative financing to gap the bridge in time between the date of project funding the date the applicable entity receives the refundable tax credit after filing its federal tax return the following year. Similarly, the transferee of a credit transfer may require a discount on the purchase price of the credit due to the fact the transferee cannot claim the credit and receive its benefit until it files its tax return the year after the credit is generated.

We expect forthcoming guidance from the U.S. Department of Treasury to clarify the manner and timing of the elections.

Outside counsel can provide guidance on the appropriate choices to make when considering taking advantage of the benefits of the Inflation Reduction Act of 2022.

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