

May 2, 2024

MEMORANDUM

TO: Carbon Capture Coalition

FROM: Hunter Johnston
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RE: Transferability Final Regulations

On April 25, 2024, the Department of Treasury and Internal Revenue Service (collectively “Treasury”) issued final regulations to implement the Inflation Reduction Act’s transferability provisions under section 6418 (the “Final Regulations”).¹ Treasury previously published on June 21, 2023, proposed regulations regarding transfer elections and temporary regulations regarding transferability registration requirements (the “Proposed Regulations”).² The Final Regulations are effective beginning July 1, 2024.

The Carbon Capture Coalition (“CCC”) filed a comment letter regarding the Proposed Regulations on August 14, 2023.³ This memorandum provides a summary of the Final Regulations. The memorandum includes an analysis of how the Final Regulations address CCC’s comment letter recommendations; if not mentioned, CCC did not comment on the issue.

The preamble to the Final Regulations highlights and discusses several areas where taxpayers requested changes or clarification but Final Regulations closely track the Proposed Regulations with very few changes.

¹ 89 Fed. Reg. 34,770 (Apr. 30, 2024) (Final Rule: Transfer of Certain Credits) *available at* <https://www.govinfo.gov/content/pkg/FR-2024-04-30/pdf/2024-08926.pdf>

² 88 Fed. Reg. 40,496 (Jun. 21, 2023) (Proposed Rule: Section 6418 Transfer of Certain Credits); 88 Fed. Reg. 40,094 (Jun. 21, 2023) (Temporary Rule: § 1. 6418-4T Additional Information and Registration).

³ IRS-2023-0028-0070, Comment from Carbon Capture Coalition to REG-101607-23 (Section 6418 Transfer of Certain Credits) *available at* <https://www.regulations.gov/comment/IRS-2023-0028-0070>.

Final Transferability Regulations

I. §1.6418-1 Transfer of Eligible Credits

The Final Regulations affirm that any taxpayer (other than a taxpayer making a direct pay election with respect to the same credit) can make a transfer election, but the preamble notes that Treasury rejected a comment to broaden the definition of “eligible taxpayer” to include taxpayers that are only subject to taxes of a territory of the United States.⁴ The Final Regulations also affirm that a partnership that has not elected to be treated as an applicable taxpayer for the direct pay election for a section 45Q, a section 45V, or a section 45X credit can qualify as an eligible taxpayer for a transfer election.⁵

The Final Regulations describe the eligible credit property for each of the 11 eligible credits.⁶ The preamble to the Final Regulations notes that Treasury agrees that, for a section 45Q credit, the taxpayer does not need to own every component of a single process train and revised the definition of eligible credit property for the section 45Q credit to state “[i]n the case of a section 45Q credit, a component of carbon capture equipment *within a single process train* described in §1.45Q-2(c)(3).”⁷

Similar to the Proposed Regulations, the Final Regulations require that the transfer must be made for cash, which includes payments by cash, check, cashier's check, money order, wire transfer, ACH transfer, or other bank transfer of immediately available funds.⁸

The Final Regulations also adopt, without change from the Proposed Regulations, a safe harbor timing rule—the payment will not violate the cash requirement if it is made within the period beginning on the first day of the eligible taxpayer's taxable year during which the eligible credit is determined and ending on the due date for the transfer election statement.⁹ The eligible taxpayer can contract in advance for the sale of one or more years of credits, as long as the cash payments are made during the safe harbor time period.¹⁰ The Final Regulations, similar to the Proposed Regulations, do not allow advance payments for future credits, which Treasury notes in the preamble would “raise several complex legal and administrative issues.”¹¹

⁴ Treas. Reg. § 1.6418-1(b); 89 Fed. Reg. at 34,771.

⁵ 89 Fed. Reg. at 34,772.

⁶ Treas. Reg. § 1.6418-1(d)(1)-(11).

⁷ 89 Fed. Reg. at 34,772; *see also* Treas. Reg. § 1.6418-1(d)(3)).

⁸ Treas. Reg. § 1.6418-1(f)(1).

⁹ Treas. Reg. § 1.6418-1(f)(2).

¹⁰ Treas. Reg. § 1.6418-1(f)(3).

¹¹ 89 Fed. Reg. at 34,773.

The Final Regulations adopt the Proposed Regulations that allow a taxpayer to transfer all or any portion of an eligible tax credit but a taxpayer cannot sever the bonus credit from the base credit and transfer them separately.¹²

II. §1.6418-2 Rules for Making Transfer Elections

A. In General

Similar to the Proposed Regulations, the Final Regulations provide that an eligible taxpayer can make multiple transfer elections for an eligible credit, as long as the aggregate amount does not exceed the amount of the eligible credit.¹³ The Final Regulations state that transfer elections cannot be made for progress expenditures or non-cash consideration.¹⁴

The Final Regulations added a new provision that provides that if an eligible taxpayer is a grantor or any other person that is treated as the owner of any portion of a trust as described in section 671 then the eligible taxpayer may make a transfer election for any eligible credits determined with respect to eligible credit property held directly by the portion of the trust that the eligible taxpayer is treated as owning under section 671.¹⁵

B. Manner and Due Date for Making a Transfer Election

The Final Regulations retain the rule that an election must be made for each eligible credit property for each taxable year of an eligible taxpayer.¹⁶ The eligible taxpayer is required to register and make an election based on the specified credit portion of an eligible credit for each of the 11 eligible credits.¹⁷

The Final Regulations also clarify that a transfer election is made when all of the requirements of Treas. Reg. § 1.6418-2(b) are satisfied, meaning the transfer is not considered made until a tax return is filed.¹⁸ The preamble to the Final Regulations note this is important for brokers and others involved in a potential secondary transfer.¹⁹

1. Special Rules for Certain Eligible Credits

The Final Regulations adopt the Proposed Regulations for eligible credits under sections 45, 45Q, 45V, and 45Y that require a separate election for each facility and for each taxable year

¹² Treas. Reg. § 1.6418-1(h).

¹³ Treas. Reg. § 1.6418-2(a)(2).

¹⁴ Treas. Reg. § 1.6418-2(a)(4)(i)-(ii).

¹⁵ 89 Fed. Reg. at 34,774; *see also* Treas. Reg. § 1.6418-2(a)(3)(v).

¹⁶ Treas. Reg. § 1.6418-2(b)(1); Treas. Reg. § 1.6418-4(c)(2).

¹⁷ Treas. Reg. § 1.6418-2(b)(3)

¹⁸ 89 Fed. Reg. at 34,774.

¹⁹ *Id.*

beginning on the date placed in service (or for section 45Q, the date the single process chain was placed in service).²⁰

The preamble to the Final Regulations notes that a commenter requested guidance on transferring section 45Q and section 45Z credits separately when they are determined on the same qualified facility.²¹ The commenter stated that the qualified facility definition under section 45Z(d)(4) should not preclude an owner and producer taxpayer from making a transfer election, even if an unrelated taxpayer who is eligible for the section 45Q credit makes a transfer election in the same taxable year.²² Treasury stated this issue is beyond the scope of the Final Regulations, but will consider the comment when drafting additional guidance under section 45Q and section 45Z.²³

2. Manner of Making a Valid Transfer Election, Due Date, and Original Return Requirement

The Final Regulations adopt the Proposed Regulations without substantive change that require the eligible taxpayer to make the transfer election on its original (and not amended) tax return not later than the due date (including extensions). The return must include Form 3800, General Business Credit, reporting the registration number and an attached schedule showing the amount of credit transferred for each eligible credit property.²⁴ There is no late election relief under Treas. Reg. §§ 301.9100-1 through 301.9100-3.²⁵

If a taxpayer incorrectly determined the amount of an eligible credit, the Final Regulations allow the taxpayer to file an amended return to correct the amount of eligible credit.²⁶ If the amount of the eligible credit is changed, the increase may not be transferred but decreases to the credit must be reflected.²⁷

3. Transfer Election Statement

The Final Regulations adopt the Proposed Regulations and require a transfer election statement to be included with the tax return, which is a written document completed by the eligible taxpayer and the transferee that includes information on the transferee, the amount of credit transferred, a statement that the parties are not related, a representation that the eligible

²⁰ Treas. Reg. § 1.6418-2(b)(2)(i)-(ii).

²¹ 89 Fed. Reg. at 34,775.

²² *Id.*

²³ *Id.*

²⁴ Treas. Reg. § 1.6418-2(b)(3)(i)-(v); (b)(4)(i).

²⁵ Treas. Reg. § 1.6418-2(b)(4)(i).

²⁶ Treas. Reg. § 1.6418-2(b)(4)(ii)(A)-(C).

²⁷ 89 Fed. Reg. at 34,776-77.

taxpayer has complied with all the requirements to make a transfer election, and a statement acknowledging the notification of recapture requirements.²⁸

The Final Regulations require the taxpayer to provide the transferee taxpayer with “minimum documentation” regarding the credit property but the Final Regulations did not provide additional information regarding the level of information required.²⁹

C. Limitations After a Transfer Election is Made

The Final Regulations affirm that a transfer election is irrevocable and a credit can only be transferred once.³⁰

D. Determining the Eligible Credit

The Final Regulations require that an eligible taxpayer must own the underlying eligible credit property and conduct the activities related to the credit, except for section 45X credits.³¹ The Final Regulations rejected CCC’s recommendation and adopted the Proposed Regulations without change that provides that a section 45Q credit that a taxpayer elects to claim under section 45Q(f)(3)(B) is not an eligible credit that can be transferred because it was not determined with respect to an eligible taxpayer.³²

- CCC Comment Letter Recommendation: CCC recommended allowing taxpayers to transfer a credit that was claimed under section 45Q(f)(3)(B) that is earned by disposing of, utilizing, or injecting qualified carbon oxide to make a transferability election. The preamble to the Final Regulations states that the taxpayer that is allowed a section 45Q credit as a result of the 45Q(f)(3)(B) election is not the taxpayer with respect to which the section 45Q credit is determined.³³ The preamble further states that “while the activities of a contractor may be necessary for a section 45Q credit to be determined, ultimately, the credit is attributable to and determined by the person that both owns the equipment and physically or contractually ensures the capture and disposal, injection, or utilization of such qualified carbon oxide” and that “[c]ontrary to commenters’ assertions, it is not sufficient for a party to only conduct carbon capture activities to be eligible for a section 45Q credit.³⁴

²⁸ Treas. Reg. § 1.6418-2(b)(5)(i)-(ii).

²⁹ Treas. Reg. § 1.6418-2(b)(5)(iv).

³⁰ Treas. Reg. § 1.6418-2(c)(1)-(2).

³¹ Treas. Reg. § 1.6418-2(d), *see also* 89 Fed. Reg. at 34,774.

³² Treas. Reg. § 1.6418-2(a)(4)(iii).

³³ 89 Fed. Reg. at 34,774.

³⁴ *Id.* at 34,775.

E. Treatment of Transfer Payments

The Final Regulations retain the rule that the cash paid for the credit is not included in the eligible taxpayer's gross income nor deductible by the transferee.³⁵

The Final Regulations also include the Proposed Rule's anti-abuse rule, which disallows a transfer election or otherwise recharacterizes the consequences of a transaction if the parties engage in the transaction or series of transactions with the principal purpose of avoiding tax liability beyond the intent of section 6418.³⁶ For example, if an eligible taxpayer under- or over-charges for services for a customer that is also purchasing credits, it may violate the anti-abuse rule.

The Final Regulations did not address CCC's recommendation regarding the tax treatment of transaction costs in a transfer election.

- CCC Comment Letter Recommendation: Both the Proposed Regulations and Final Regulations did not address the tax treatment of transaction costs in a transfer election. The Proposed Regulations requested comments on the treatment of transaction costs.³⁷ The preamble to the Final Regulations states this issue was not addressed because it was beyond the scope of the regulations but Treasury anticipates issuing further guidance on this issue.³⁸

F. Transferee's Treatment of Eligible Credit

The Final Regulations adopt the Proposed Regulations that if the transferee pays less for the eligible credit than the credit amount, there is no gross income to the transferee.³⁹ Further, the transferee does not apply rules that relate to the determination of the eligible credit, such as the rules in section 49 (at-risk rules) or section 50(b) (certain property not eligible for a credit), but the transferee must apply rules that relate to its own particular circumstances, such as the rules in section 38 (computation of general business credit) or section 469 (passive activity limitation).⁴⁰

III. §1.6418-3 Additional Rules for Partnerships or S Corporations.

The Final Regulations adopt the Proposed Regulations related to the rules for partnerships and S corporations without change. The Final Regulations provide that a partnership or S corporation may qualify as a transferor or transferee.⁴¹ The amount of eligible credit

³⁵ Treas. Reg. § 1.6418-2(e)(2)-(3).

³⁶ Treas. Reg. § 1.6418-2(e)(4).

³⁷ 88 Fed. Reg. at 40,502.

³⁸ 89 Fed. Reg. at 34,797-98.

³⁹ Treas. Reg. § 1.6418-2(f)(2).

⁴⁰ Treas. Reg. § 1.6418-2(f)(3)(i)-(ii).

⁴¹ Treas. Reg. § 1.6418-3(a)(1).

determined by a transferor partnership or S corporation may be limited by section 49 (at-risk rules).⁴²

The cash payment would be treated as tax-exempt income for the partnership or S corporation for purposes of sections 705 and 1366.⁴³ Tax-exempt income resulting from a transfer election made by a partnership or S corporation is not treated as passive income to any partners or shareholders who do not materially participate.⁴⁴

IV. §1.6418-4 Additional Information and Registration

The Final Regulations adopt the Proposed Regulations pre-filing registration requirements.⁴⁵ Further, each applicable property must obtain its own registration number.⁴⁶ A taxpayer who does not obtain a registration number before filing and does not include the registration number on its annual return is ineligible to transfer the credits.⁴⁷ Registration numbers can only be obtained through the IRS electronic portal.⁴⁸

The Final Regulations adopt the Proposed Regulations' requirement that the taxpayer to include certain information about the eligible taxpayer and eligible credit property, including name, TIN or EIN, type of entity, the taxpayer's taxable year, the credit(s) being elected, and physical location, supporting documentation, and type of eligible credit property.⁴⁹

Transfer registration numbers are valid only for one taxable year and the Final Regulations adopt the Proposed Regulations' requirement that the taxpayer must renew the registration for a subsequent taxable year, including attesting that all the facts previously provided are still correct or updating any facts.⁵⁰

- CCC Comment Letter Recommendation: CCC recommended streamlining the registration process by clarifying the definition of a facility and clarifying that taxpayers do not need to provide full documentation for annual registrations if the facts from the previous taxable year are unchanged. The Final Regulations adopt the Proposed Regulation's registration and filing requirements without changes. The preamble to the Final Regulations notes that the "IRS will consider ways outside of

⁴² Treas. Reg. § 1.6418-2(d)(2).

⁴³ Treas. Reg. § 1.6418-3(a)(2)(i).

⁴⁴ Treas. Reg. § 1.6418-3(a)(5).

⁴⁵ Treas. Reg. § 1.6418-4(a)-(b).

⁴⁶ Treas. Reg. § 1.6418-4(b)(4).

⁴⁷ Treas. Reg. § 1.6418-4(a).

⁴⁸ Treas. Reg. § 1.6418-4(b)(1).

⁴⁹ See Treas. Reg. § 1.6418-4(b)(5).

⁵⁰ Treas. Reg. § 1.6418-4(c)(2).

the final regulations to make the pre-filing registration process more streamlined for eligible taxpayers.”⁵¹

V. §1.6418-5 Special Rules/Excessive Payment

The Final Regulations adopt the rule in the Proposed Regulations that a 20-percent penalty is imposed on a transferee if the amount of the transfer payment is excessive.⁵² This penalty does not apply if the taxpayer demonstrates that the excessive payment was due to reasonable cause.⁵³ Any recapture tax under section 50(a), 49(b), or 45Q(f)(4) is imposed on the transferee, but there is no prohibition against a contractual indemnity by the eligible taxpayer to the transferee.⁵⁴

⁵¹ 89 Fed. Reg. at 34,789.

⁵² Treas. Reg. § 1.6418-5(a)(1).

⁵³ Treas. Reg. § 1.6418-5(a)(4).

⁵⁴ Treas. Reg. § 1.6418-5(d),(e).