

What Tax-Exempt Orgs. Need From Energy Credit Guidance

By **Ann Batlle, Celia Roady and Dan Carmody** (May 31, 2023, 5:08 PM EDT)

The Inflation Reduction Act of 2022 opened up many energy credit opportunities for tax-exempt organizations. Further guidance on the credit regime is anticipated in the coming months, which should help organizations determine the benefits of clean energy projects.

The Inflation Reduction Act created new opportunities for tax-exempt organizations to participate in the benefits of various energy credits. Section 6417 of the Internal Revenue Code now permits tax-exempt organizations to effectively receive cash payments from the government in lieu of claiming certain energy tax credits.

IRC Section 6418 further creates a market for these clean energy credits by permitting tax-exempt organizations to transfer these credits to nonexempt taxpayers in exchange for cash, and treats those payments as nontaxable to the exempt organization.

The act includes increasing incentives for projects in low-income communities, using domestic content in projects, and utilizing workers that meet prevailing wage and apprenticeship standards. Layering on all the various incentives could result in applicable tax-exempt organizations receiving payments from the government ranging from 30% to 70% of the cost of a qualifying energy project.

The government requested comments in October 2022 on additional guidance necessary to implement the regime. Officials from the U.S. Department of the Treasury recently indicated that guidance is anticipated by this summer.

Basic Structure Of The Credit Regime

Section 6417(a) provides that an applicable entity can elect to treat a wide range of energy credits as direct payments against tax. There are a variety of energy credits that qualify, including the familiar production tax credit for renewables under Section 45 and the investment tax credit for alternative energy property under Section 48, as well as a number of newer energy tax credits.

Because the credit amount will be treated as a direct payment against tax, the benefit under Section 6417 will presumably flow to the applicable entity as a tax refund.



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Section 6417 does not provide substantive rules for the applicable credits. A tax-exempt organization seeking the benefit of Section 6417 would have to fully comply with the requirements of the applicable credit.

This has always been a complicated area of the tax law, and the act added to the complexity by making the full amount of certain credits dependent on the construction of the energy property complying with prevailing wage and apprenticeship standards or domestic content requirements.

In addition, there is the potential for additional bonus credits, known as adders, if the project involves a specified amount of domestic content or if the project is located in certain specified energy communities, which include low-income communities and brownfield sites.

Projects that feature all of these adder incentives could receive a payment from the government equal to 30% or more of the cost of a solar or wind project, for example.

Many of the energy credits require a basis reduction in the underlying property and a recapture in a subsequent year if the underlying property is transferred or stops being qualified property within five years. Section 6417(g) specifically indicates that similar rules will apply for purposes of Section 6417.

In addition, if the credit amount is overcalculated, then Section 6417(d)(6) treats the applicable entity as making an excessive payment against its tax liability. In that case, the excessive portion of the payment plus an amount equal to 20% of the excessive payment are treated as taxable income for the applicable entity in the year the excessive payment is determined, effectively creating a 120% penalty.

Who Can Benefit

In general, an applicable entity is:

- Any tax-exempt organization;
- Any state or political subdivision thereof;
- The Tennessee Valley Authority;
- Any Native American tribal government;
- Any Alaska Native corporation; or
- Any corporation operating on a cooperative basis that is engaged in furnishing electric energy to persons in rural areas.

In addition, if the credit is generated within a partnership or S corporation, the partnership or S corporation will make the election under Section 6417, and the government will pay the credit amount directly to the partnership or S corporation so that it can be distributed to the partners or shareholders. It is not yet clear how the provision would — or could — apply to a partnership with taxable and tax-exempt partners.

Many comments have noted that while an applicable entity includes any state or political subdivision

thereof, it does not explicitly include instrumentalities of a state or local government.

If this is the correct interpretation, then there could be illogical exclusions from Section 6417. For example, a city could receive the incentive for a solar project, but a nearby public university or an adjoining port authority could not.

The forthcoming guidance will likely address whether such instrumentalities are included as applicable entities or not.

Past Lessons and an Anticipated Registration Process

Government officials have hinted about some of the framework that will emerge for Section 6417. Treasury officials indicated last week that they anticipate creating a prefiling registration process aimed at preventing fraud.

In many ways, Section 6417 is evocative of Section 1603 of the American Recovery and Reinvestment Act, which permitted taxpayers to elect to receive grants in lieu of tax credits under Section 45 or Section 48 for specified energy property.

There were eventually inquiries from Congress about the potential for fraud in the program and the U.S. Department of Justice pursued some claimants under the False Claims Act.

At the end of 2013, the Treasury Inspector General for Tax Administration released a report concluding that the Internal Revenue Service "needs a process to identify taxpayers that receive Section 1603 grants as well as ITC [investment tax credit] benefits from the same property." [1] Section 6417(d)(5) directs the secretary to require information or registration deemed necessary to prevent duplication, fraud, improper payments or excessive payments.

The Section 1603 grant program was not available to tax-exempt organizations or governmental entities, so the limited availability of Section 6417 may present fewer fraud concerns, but the recent report from the Joint Committee of Taxation clearly links Section 6417 with the prior concerns about the Section 1603 grant program. [2]

Possible Applications

Even before the act, tax-exempt organizations had been investing in renewable energy through power purchase agreements with solar and wind farms.

Section 6417 now opens up many new possibilities, particularly for exempt organizations interested in reducing the carbon footprint associated with their operations. In particular, exempt organizations that work in low-income communities could realize significant benefits from some of the added provisions of the new credit regime that are focused on environmental justice.

- Pending clarification of the instrumentality issue, a large police force or transit agency, or other exempt instrumentality, may be interested in benefits of the Section 45W credit for qualified commercial clean vehicles.
- An applicable entity that focuses on housing issues may invest in a residential solar property that it can lease or otherwise make available for low-income housing.

- Local governments may now have a federal subsidy for renewable projects.

Open Questions

This summer's anticipated guidance around Sections 6417 and 6418 should begin to clarify how tax-exempt organizations will be able to access the benefits of this new credit regime.

In addition to the uncertainty identified above with respect to the definition of an "applicable entity," questions remain regarding the following:

- **Timing:** Will an expedited payment process be created, such as the Form 4466 tentative refund for an overpayment of estimated taxes?
- **Penalties:** Will there be overlap between the Section 6676 erroneous claim for refund penalty and the excessive payment rules of Section 6417(d)(6)?
- **Preregistration requirements:** Will the preregistration be streamlined, or will it function like a mini audit of eligibility for the underlying credit?
- **Credit markets:** Will applicable entities be allowed to buy credits under Section 6418 and then claim the benefit of Section 6417?
- **Partnerships:** Under Section 6417, partnerships must make direct pay and transferability elections with respect to partnership property. Can they make these elections on behalf of exempt organizations, or perhaps make different elections for different partners?

While there are many open questions, it is important to note many of these clean energy credits have been in effect for some time with respect to other taxpayers, and there are existing rules and procedures that will also have to be met for tax-exempt organizations to take advantage of these new credit provisions.

The anticipated guidance, together with existing credit rules, should put tax-exempt organizations in a better position to determine the benefits of clean energy projects in their work and integrate investments in alternative energy into their activities.

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[1] Inspector General for Tax Administration, Department of the Treasury, Review of Section 1603 Grants In Lieu of Energy Investment Tax Credit (TIGTA 2014-IE-R006), December 17, 2013.

[2] Joint Committee on Taxation, Description of Energy Tax Changes Made by Public Law 117-169 (JCX-5-23), April 17, 2023. This document can be found on the Joint Committee on Taxation website, www.jct.gov.

