

Alert

November 27, 2023



IRS Proposes Helpful Rules for Energy Tax Credits

On November 22, 2023, the Internal Revenue Service published proposed regulations concerning Sections 48, 6417, and 6418. These proposed rules would affect the conditions for claiming energy credits, the amount of energy credits that may be claimed, the conditions under which those energy credits may be recaptured, and the persons liable for recaptured credits.

The proposed regulations cover a lot of ground. A thorough review is beyond the scope of this alert. For this alert, we discuss the following highlights:

Tax-Exempts May Claim Direct Pay Even If Property Not Used in Unrelated Trade or Business

Energy property qualifies for energy credits only if the property is placed in service. A tax-exempt normally may treat its property as “placed in service” only if it uses the property in an unrelated trade or business. The proposed rules would allow a tax-exempt to elect to treat energy property as used in a trade or business for purposes of claiming direct payment under Section 6417.

Retrofitted Property Can Qualify as Originally Placed in Service under 80/20 Rule

The proposed regulations provide that property that is retrofitted can qualify as energy property originally placed in service provided it satisfies the 80/20 Rule. It satisfies the 80/20 Rule that the fair market value of used property in the retrofitted energy property unit is no more than 20% of the property unit’s total value (cost of new property plus the fair market value of the used property).

Dual Use Threshold Reduced to 50%

The Dual Use Property Rule applies to any property that uses energy generated from qualified sources (property qualifying as energy property under Section 48) and nonqualifying sources. Under the rule, if more than 50% of the energy used by that property (annually) is derived from nonqualifying sources, it will not be eligible for the Section 48 energy credit. Put differently, a property may qualify for energy credits even if up to 50% of the energy used by that property is derived from non-qualifying sources.

Energy Storage Technology Guidance

The proposed regulations provide a non-exclusive list of energy storage technology types. Significantly, the list includes batteries and other energy storage technologies that charge or recharge vehicles used to transport good or people, provided that those energy storage technologies are physically separate from the vehicles.

The Energy Property Unit Includes Functionally Interdependent Components and Integral Parts

Any energy property can include components and properties that are not energy property under a statutory energy property definition, but are functionally interdependent with, or are integral parts of, energy property. The proposed regulations would include in energy property basis the costs of these components and properties. For example, in the case of offshore wind, power conditioning



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and transfer equipment that act on the power generated by turbines are integral parts of the energy property (the wind facility). Roads used for equipment and maintaining energy property are also integral parts of that energy property.

Components of Energy Property Owned by Different Taxpayers

The proposed regulations provide that the taxpayer that owns the energy property can include its share of costs in certain integrated property with different ownership. For example, in an offshore wind power project, one taxpayer may own the power generating property (the turbines) and another taxpayer may own integral parts of the energy property such as subsea cables and transformers. The rules provide that only the taxpayer who owns the energy property (turbines) can claim an energy credit. If that taxpayer also has an interest in the integral parts of the energy property, its energy credit basis includes its investment in those integral parts.

Prevailing Wage and Apprenticeship Reporting and Recapture

The proposed rules also establish annual reporting requirements related to prevailing wage and apprenticeship requirements (PWA Requirements). The initial compliance year begins on the date the energy property was placed in service and ends 365 days (366 for a leap year) later. Each subsequent year has either 365 or 366 days, depending on whether it is a leap year. Failure to comply with PWA Requirements for the five-year period results in recapture. The recaptured amount is limited to the bonus credit claimed for meeting prevailing wage and compliance. Persons who acquire credits under Section 6418 are responsible for reporting and also liable for taxes related to a recapture.

Performance and Quality Standards; Energy Efficiency Standards

Energy property must meet performance and quality standards (if any) prescribed by the IRS in consultation with the US Department of Energy. The proposed regulations include such standards for small wind energy property and electrochromic glass property. In addition, the proposed rules establish methods for determining electricity only generation efficiency for qualified fuel cells and qualified microturbine property.
