PUBLICATION

Clean Energy Credits Under the Inflation Reduction Act: Credit Sales and Prevailing Wage Bonus

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September 03, 2024

The Internal Revenue Service (IRS) and the Department of the Treasury (DOT) released regulations on Section 6418 of the Internal Revenue Code of 1986, as amended (the Code), on July 1, 2024, concerning the transfer of certain clean energy tax credits to unrelated taxpayers under the Inflation Reduction Act of 2022 (IRA). Additionally, taxpayers can take advantage of a five-time bonus of the credit amount by meeting certain labor requirements. Because any amount of cash paid in exchange for these credits is not included in the transferor's gross income, taxpayers should utilize available bonus incentives to maximize tax credit amounts. In many instances, clean energy projects would not be economically viable without these bonus incentives.

One such bonus applies when a taxpayer or project meets certain requirements under the Prevailing Wage Act (PWA). If the taxpayer or project meets the PWA requirements, the BOC Exception (beginning of construction occurring before January 29, 2023), or meets the One-Megawatt Exception (maximum net output or capacity for energy storage of less than one megawatt), the base applicable tax credit amount will be multiplied by five times. The IRS and the DOT recently issued final regulations providing the record-keeping and reporting requirements for taxpayers taking advantage of the PWA bonus; these regulations are effective on August 26, 2024. These final regulations, under Code Section 45, amend Code sections 30C, 45, 45L, 45Q, 45U, 45V, 45Y, 45Z, 48C, and 179D credits under the IRA.

This memorandum will discuss the new credit transferability rules, as well as the rules established by the PWA, as it pertains to the requirements to receive the increased credit amounts. First, this memorandum will discuss which credits are eligible for transfer at all, then explore the "paid in cash" requirement for transfer and the mechanics of transfer. Then, this memorandum will discuss the Prevailing Wage Act's bonus requirements in further detail.

1. Transferable Clean Energy Tax Credits

The following eligible clean energy credits may be transferred to unrelated taxpayers for cash:

- Energy Credit (Code § 48);
- Qualified Advanced Energy Project Credit (Code § 48C);
- Clean Electricity Investment Credit (Code § 48E);
- Renewable Electricity Production Credit (Code § 45);
- Clean Electricity Production Credit (Code § 45Y);
- Zero-Emission Nuclear Power Production Credit (Code § 45U);
- Advanced Manufacturing Production Credit (Code § 45X);
- Clean Hydrogen Production Credit (Code § 45V);
- Clean Fuel Production Credit (Code § 45Z);
- Carbon Oxide Sequestration Credit (Code § 45Q); and
- Credit for Alternative Fuel Vehicle Refueling/Recharging Property (Code § 30C).

2. Paid in Cash and Unrelated Transferee Taxpayers

Section 6418 requires that any amount of consideration paid for a tax credit must be "paid in cash." Treasury Regulation § 1.6418-1(f) says that the "paid in cash" requirement is satisfied if the consideration is paid in United States Dollars (USD) (by cash, check, cashier's check, money order, wire transfer, automated clearing house (ACH) transfer, or other bank transfer of immediately available funds); made within the period beginning on the first day of the eligible taxpayer's taxable year during which a specified credit portion is determined and ending on the due date for completing a transfer election statement; and may include a transferee taxpayer's contractual commitment to purchase eligible credits with USD in advance of the date a specified credit portion is transferred to such transferee taxpayer, as long as taxpayers continue to abide by the paid in cash and timing requirements set forth in Treasury Regulation §§ 1.6418-1(f)(1) and (2).

3. Partnerships and S-Corporations

Any amount of cash received for a transfer of a clean energy credit portion, held directly by a partnership or an S-corporation, will be treated as tax-exempt income and is not treated as passive income to those partners who do not materially participate within the meaning of section Code § 469(c)(1)(B). Additionally, there is flexibility for partners, in their partnership agreements, to determine their individual distributive portions of the clean energy credit. This same flexibility however is not extended to S-corporation shareholders, as it would run afoul of the second class of stock rule.

4. Anti-Abuse Rule and Recapture

The Final Regulations prohibit the transfer of clean energy tax credits for the purpose of avoiding federal tax liability beyond the intent of Code § 6418; for example, a party may not affect a transfer for the principal purpose of avoiding gross income. An example under Reg. § 1.6418-2 identifies that clean energy credits transferred in lieu of payment for services will be recharacterized as a taxable transfer. If a party makes a transfer election for a purpose extending beyond the intent of Code § 6418, the transfer may be disallowed, or the federal income tax consequences of the transaction affecting the transfer may be recharacterized.

5. REITs

The Final Regulations clarify that credits not yet transferred are disregarded for purposes of the REIT Asset Test under Code § 856(c)(4). Additionally, sales of a specified credit portion are not considered sales under Code § 856(b)(6)(C)(iii) and (D)(iv) of the same. Therefore, REITs will not be deterred from participation in the transfer of eligible credits.

Wage Act Requirements: Effective Under August 2024 Regulations

Generally, the Prevailing Wage Act bonus under the IRA is available when the taxpayer pays the project's laborers and mechanics a certain wage. Final Treasury Regulation § 1.45-7(b)(1) states that a taxpayer satisfies the Prevailing Wage Requirements with respect to a qualified facility if the taxpayer ensures that laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction, alteration, or repair (hereinafter collectively referred to as "work") of the facility are paid wages at rates not less than those set forth in the applicable wage determination issued by the Secretary of Labor pursuant to 40 U.S.C. 3142, 29 CFR part 1, and other implementing guidance for the specified type of construction in the geographic area where that facility is located.

1. Apprenticeship Programs

There is also an apprenticeship requirement to fulfill the PWA's requirements. Code section § 45(b)(8)(E)(ii) defines a "qualified apprentice" as an individual who is employed by the taxpayer or by any contractor or subcontractor and who is participating in a registered apprenticeship program, as defined in Code § 3131(e)(3)(B). Additionally, for purposes of the Davis Bacon Act (DBA), an apprentice may also include an individual in the first 90 days of probationary employment as an apprentice in a registered apprenticeship

program, who is not individually registered in the program, but who has been certified by the DOL Office of Apprenticeship or a state apprenticeship agency to be eligible for probationary employment as an apprentice.

A registered apprenticeship program is one that is approved by the DOL's Office of Apprenticeship or a state apprenticeship agency recognized by the Office of Apprenticeship. Program registration is evidenced by a Certificate of Registration or other written indicia of registration. A Registered Apprenticeship sponsor is responsible for administering the apprentice program and may be any employer, association, committee, or organization operating an apprenticeship program and in whose name the program is (or is to be) registered or approved. A sponsor describes any person, association, committee, or organization operating an apprenticeship program and in whose name the program is (or is to be) registered or approved.

2. What is a Prevailing Wage?

A prevailing wage is the combination of the basic hourly wage rate and any fringe benefits rate paid to workers in a specific classification of laborer or mechanic in the geographic area where work is performed, as most recently determined by the Secretary of Labor in accordance with the DBA. A taxpayer satisfies the Prevailing Wage Requirements with respect to a qualified facility, if the taxpayer ensures that laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the work of the facility are paid wages at rates not less than those set forth in the applicable wage determination issued by the Secretary of Labor pursuant to 40 U.S.C. 3142, 29 CFR part 1, and other implementing guidance for the specified type of construction in the geographic area where that facility is located.

A. Bona Fide Fringe Benefits

Apprentices must be paid bona fide fringe benefits to satisfy the PWA. This means that the employer must pay apprentices fringe benefits in accordance with their qualified program terms. In the absence of defined fringe benefits terms in the plan, apprentices must be paid the full amount of bona fide fringe benefits listed on the Secretary of Labor's (SOL) wage classification, in cash. Additionally, 40 U.S. Code Section 3141 defines the value of bona fide fringe benefits where the contractor or subcontractor is not required by other federal, state, or local law to provide any of those benefits (presumably, in the absence of program terms). In this case, the value of the bona fide fringe benefits is: (i) the rate of contribution irrevocably made by a contractor or subcontractor to a trustee or to a third person under a fund, plan, or program; and (ii) the rate of costs to the contractor or subcontractor that may be reasonably anticipated in providing benefits to laborers and mechanics pursuant to an enforceable commitment to carry out a financially responsible plan or program which was communicated in writing to the laborers and mechanics affected.

B. Wage Determination for a Specific Geographic Area

Taxpayers must ensure that laborers and mechanics (those workers whose duties are manual or physical in nature, as distinguished from mental or managerial) employed by the taxpayer or any contractor or subcontractor in the work of the facility are paid wages at rates not less than those set forth in the applicable general wage determination(s) published by the U.S. Department of Labor on the approved website. The applicable general wage determination is the general wage determination in effect for the specified type of construction in the geographic areas at the time a contract for the work of the facility is executed by the taxpayer (or the taxpayer's designee, assignee, or agent) and any contractor. In the absence of a contract (or if the date of execution of the contract cannot be reasonably determined), the applicable general wage determination is the general wage determination in effect for the specified type of construction in the geographic area when the work of the facility starts.

In the event the SOL has not issued a general wage determination for the relevant geographic area and type of construction for the facility, or the SOL has issued a general wage determination for the relevant geographic

area and type of construction, but one or more labor classifications for the work that will be done on the facility by laborers or mechanics is not listed, the taxpayer must ensure that laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the work of a facility are paid wages at rates not less than those set forth in a supplemental wage determination or in an additional classification and wage rate issued to the taxpayer by the DOL upon request by the taxpayer, contractor, or subcontractor in accordance with Treasury Regulation § 1.45-7(b)(3)(ii). A taxpayer, contractor, or subcontractor may also request a supplemental wage determination if the location of the facility involves work by covered laborers and mechanics that spans more than one contiguous geographic area. Requests for supplemental wage determinations or additional classifications and wage rates must be submitted to the DOL by email at IRAprevailingwage@dol.gov.

3. Apprenticeship Labor Hours Requirement

The taxpayer must ensure that the "applicable percentage" of the total labor hours are performed by qualified apprentices, with respect to any qualified facility, in order to claim or transfer (under Code § 6418) an increased credit amount. The total labor hours worked at a qualified facility are aggregated during the construction of the facility and divided by the total hours worked by qualified apprentices. The applicable percentage is: (i) in the case of a qualified facility the construction of which begins before January 1, 2023, **10 percent**; (ii) in the case of a qualified facility the construction of which begins after December 31, 2022, and before January 1, 2024, **12.5 percent**; and (iii) in the case of a qualified facility the construction of which begins after December 31, 2023, **15 percent**.

4. Ratio Requirement in Registered Apprenticeship Programs

Taxpayers must also comply with an apprentice to journeyworker ratio. Apprentice to journeyworker ratios are established in the standards developed by Registered Apprenticeship program sponsors, in accordance with the requirements of the U.S. DOL's Office of Apprenticeship or an applicable State Apprenticeship Agency. The required ratios of apprentices to journeyworkers, outlined in apprenticeship programs, are consistent with proper supervision, training, safety, and continuity of employment, and applicable provisions in collective bargaining agreements, except where such ratios are expressly prohibited by the collective bargaining agreements. The ratio language must be specific and clearly described as to its application to the job site, workforce, department, or plant.

A. Participation Requirement

The Participation Requirement states that each taxpayer, contractor, or subcontractor employing four or more individuals to perform work with respect to the construction of a qualified facility must employ one or more qualified apprentices to perform such work. Taxpayers who fail to meet the Participation Requirement would be subject to the penalty provisions of section 45(b)(8)(D), even if the taxpayer otherwise satisfies the applicable Labor Hours Requirement unless the Good Faith Effort Exception applies.

5. Recordkeeping and Reporting

With respect to each qualified facility for which a taxpayer is claiming or transferring (under section 6418) a credit reflecting an increased credit amount, the taxpayer must, at a minimum, maintain certain records including payroll records for each laborer, mechanic, qualified apprentice employed to work on the facility. In addition to this requirement, there are a number of additional minimum recordkeeping and reporting requirements, established in Section 1.45-12 that may be applicable to certain taxpayers.

Conclusion

Taxpayers who wish to transfer clean energy credits or maximize the allowable increased credit available after fulfilling the Prevailing Wage Act requirements should contact Baker Donelson's Tax group to ensure compliance under these regulations.