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Energy Tax Credit Update for Tax-Exempts: Elective Pay Requirements Clarified

The "elective pay" option enacted by the Inflation Reduction Act (IRA) opened new opportunities for tax-exempt entities to take advantage of various energy tax credits. (See related article, "How Nonprofits and Local Governments Can Leverage Sustainability Tax Credits" in the Winter 2023 Nonprofit Standard). Final regulations issued by the IRS in March clarify eligibility for the election and the required filing procedures. Nonprofit organizations, state and local governments, and other applicable entities should review their eligibility to benefit from credits under the elective pay option and the necessary procedural requirements to qualify.

Elective Pay Monetization of Eligible Tax Credits

The IRA introduced Section 6417 to the Internal Revenue Code, which provides applicable entities the option to monetize eligible renewable energy tax credits that they would otherwise not be able to utilize. The credits are treated as a refundable payment (elective pay) against federal income taxes, effectively providing a cash grant in the amount of the tax credit.

Applicable entities eligible for elective pay generally include nonprofit organizations, any state along with the District of Columbia and political subdivisions, tribal governments and their subdivisions, Alaska Native corporations, the Tennessee Valley Authority, rural electric cooperatives, and agencies or instrumentalities of certain eligible entities.

Eligible credits for elective pay specifically include:

- Energy credit (Section 48)
- Clean electricity investment credit (Section 48E)
- Renewable electricity production credit (Section 45)
- Clean electricity production credit (Section 45Y)
- Commercial clean vehicle credit (Section 45W) - tax-exempts only
- Zero-emission nuclear power production credit (Section 45U)
- Advanced manufacturing production credit (Section 45X)
- Clean hydrogen production credit (Section 45V)
- Clean fuel production credit (Section 45Z)
- Carbon oxide sequestration credit (Section 45Q)
- Credit for alternative fuel vehicle refueling/recharging property (Section 30C)
- Qualifying advanced energy project credit (Section 48C)

On March 5, the Department of the Treasury and the IRS released final regulations for the elective pay election (TD 9988). The final regulations clarified which entities are qualified to opt for the elective pay election and outlined the filing procedures, among other guidance. The IRS also updated the frequently asked questions for elective pay based on the final regulations. For prior coverage on the final regulations, see BDO's Tax Alert "Treasury, IRS Release Final Regulations on Elective Pay Election for Energy Tax Credits."

Elective Pay Procedures

Applicable entities claim the credit by first completing a prefiling registration process with the IRS that results in a credit registration number. The registration form requests information including, but not limited to, the entity generating the credit, credit type, associated facility, project timeline (e.g., construction start and placed-in-service dates) and project source of funds. The IRS recommends completing the registration form no later than 120 days before planned election filing. Any elective pay election submitted to the IRS without a valid registration number will be deemed ineligible for payment.

Additionally, the appropriate tax forms must be completed (e.g., Form 3468 and Form 3800 for an energy credit) and included on an original, timely filed return (including extensions) with the elective pay election. It is important that taxpayers keep books and records associated with the credit calculation and supporting documentation. Organizations that already file an annual tax return would continue to file that return with the appropriate tax credit form. Organizations that do not normally file an annual information return with the IRS must use a Form 990-T. Further, for organizations that do not normally have tax filing requirements and follow a fiscal year, a different tax year-end may be adopted from its current accounting year-end for purposes of the elective pay election. Taxpayers that do adopt a different year-end for elective pay must maintain adequate books and records to reconcile any differences with their usual tax year-end.

Considering public feedback, the final regulations also update prior guidance and provide for administrative adjustment requests to correct elective pay elections with good faith reporting errors such as credit calculation mistakes or typographical errors.

Observations

Several opportunities have emerged for applicable entities through investments that may qualify for the energy credit under Section 48. Common examples include investments in solar property, energy storage systems and electrochromic glass, among others. Numerous projects previously shelved due to financial constraints are now viable, thanks to the cash subsidy provided by the elective pay option.

Understanding the filing requirements for elective pay is crucial. Taxpayers eligible for an elective pay election might miss out on its benefits due to procedural oversights. Consulting a tax advisor early is advisable for entities anticipating opting for elective pay.

The energy-efficient commercial buildings deduction under Section 179D has also gained popularity. However, it has been a source of confusion in relation to elective pay. It is important to note that this deduction is not a tax credit; instead, Section 179D offers a deduction aimed at reducing taxable income. For tax-exempt entities, this deduction can be allocated to the designer of the energy-efficient commercial building.

State and local governments, among other applicable entities, may receive tax-exempt grants and loans to support renewable energy investments. When acquiring energy property with certain tax-exempt grants and preferential financing, entities must be mindful of two rules affecting the credit calculation: (1) tax-exempt amounts are includable in the property's basis, and (2) there must be no "excess benefit" from using restricted tax-exempt amounts for acquiring investment-related credit property. This means the eligible credit amount may be capped based on the restricted tax-exempt amount and the cost of the energy property.