Navigating the Complex World of Tax Credits and Renewable Energy Incentives

Nutter | BDO

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With You Today

HOST

MARK TARALLO

Partner, Corporate + Transactions
Nutter

Boston, MA

LISA KEITH

Managing Director
BDO USA

Boston, MA

SCOTT MASAITIS

Partner, Tax
Nutter

New York, NY

The Inflation Reduction Act

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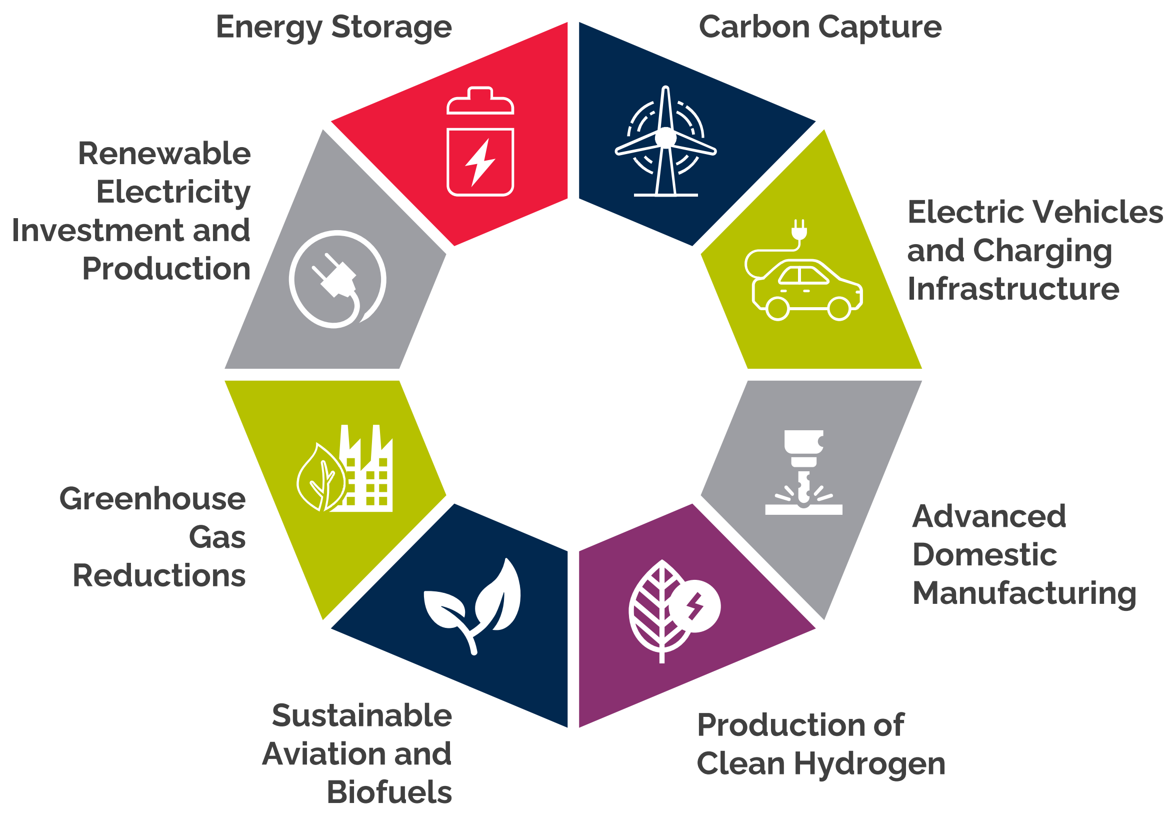
The Inflation Reduction Act (IRA) is the largest-ever U.S. investment committed to combat climate change, allocating $369 billion to energy security and clean energy programs over the next 10 years with a goal of reducing greenhouse gas emissions and incentivizing green energy investment.

The IRA:

- Introduces new credits and structures
- Extends and enhances many of the current energy-related tax credits
- Provides credits for domestic manufacturing of clean energy components
- Adds additional monetization options
- Provides tax-exempt entities the ability to claim credits via direct pay



The Inflation Reduction Act

The IRA also introduces a new credit structure with Base and Bonus Credits:

- Base credit rates with bonus rates of up to 5X the base rate
- Bonus credits subject to prevailing wage and apprenticeship requirements
- Projects under 1MW or that begin construction prior to 60 days after Treasury guidance automatically qualify for bonus rates

Additional Bonus Credits are available beginning in 2023:

- Domestic Content (up to 10% bonus)
- Energy communities (up to 10% bonus)
- Low-income communities (10% to 20% bonus)

Energy Credits & Incentives (“ECI”)

Renewable Energy Incentives

Categories of Transferable Tax Credits

Category	Description
Transportation	
Alternative Fuel Refueling Property Credit (ITC)	An investment credit for electric vehicle charging infrastructure
Clean Fuel Production Credit (PTC)	A production credit for each gallon equivalent of low GHG transportation fuel produced
Clean Energy Generation	
Renewable Electricity Production Credit (PTC)	A production credit at a wind farm for each kwh produced
Renewable Energy Investment Credit (ITC)	An investment credit against eligible capital expenditures. i.e., an energy storage project
Clean Hydrogen Production Credit (PTC)	A production credit for each gallon equivalent of green hydrogen produced
Manufacturing	
Advanced Energy Project (ITC)	An investment credit against eligible capital expenditures related to production expansion
Advanced Manufacturing Production Credit (PTC)	A production credit for each eligible component produced by a qualifying manufacturer
Carbon Sequestration	
Carbon Oxide Sequestration Credit	A production credit for each metric ton of carbon sequestered

ECI Case Study

Company: Hospitality & Leisure Operator

Overview

Industry	Hospitality
Location	Southern California
Total Project Costs	$10MM
Type of Project	Solar and Battery Energy Storage System
Need for ECI	Compliance with base (PWA) and bonus rates

BDO Benefits

- Maintained compliance with Prevailing Wage and Apprenticeship
- The Company received a 40% ITC credit against their ITC eligible expenditures
- Net Cash Benefit of $3.2MM by consulting with BDO

Projected Outcomes

Section 48 ITC Credit Basis	$10MM
Section 48 ITC Credit Rate	40%
Net Cash Benefit	$4MM

Description	W/O PWA	W/ PWA
Base Rate	6%	30%
Domestic Content Bonus	2%	10%
Total ITC Credit Rate	8%	40%
ITC Credit Value	$800,000	$4,000,000
Net Benefit with BDO	N/A	$3,200,000

Tax Credit Monetization

Tax Credit Monetization

- Tax credit monetization grants the ability to monetize tax renewable energy tax credits in two ways:

  (1) Transfer the tax credits to an unrelated third party (a C Corporation) in exchange for cash.

  (2) Make an elective pay election to receive a direct refund in the amount of the tax credits (only available to certain entities, such as tax-exempts)

- Historically, a taxpayer needed to be a direct or indirect owner of an energy project to benefit from the tax credits associated with that project.

Transferable Tax Credits	Elective Pay Tax Credits*
Sections 30C, 45, 45Q, 45U, 45V, 45X, 45Y, 45Z, 48, 48C, and 48E	Sections 30C, 45, 45Q, 45U, 45V, 45W, 45X, 45Y, 48, 48C, 48E

**Specific requirements apply depending on entity type.*

Tax Equity vs. Transferability

Pre-IRA
Traditional Tax Equity

Developer

Tax equity investor

1% of tax benefits

65% of funds

35% of funds

- **99% of tax benefits**
- **2% preferred cash distribution**
- **Cash buyout in year 6 or 7**

Tax equity partnership

Post-IRA
Tax Credit Transfer

Seller
(Developer / tax equity partnership)

Tax credits

Cash / $0.XX per $1.00 credit

Buyer
(corporate taxpayer)

<u>Benefits Of a Tax Credit Transfer Compared to Tax Equity:</u>

- Minimal accounting complexity
- Limited risks such as operational/project risks as the corporate buyer of tax credits is only purchasing the rights to the tax credit(s) and is not considered an owner of the assets
- Simplified tax reporting as ownership of the project no longer required
- Cash tax savings, free cash flow, and US GAAP effective tax rate benefit

Risks and Mitigation

Risk Category	Documents for Due Diligence/Risk Mitigation
Qualification – *Does the project or activity qualify for the credit and any applicable bonus credits/adders?*	▪ Utility permission to operate letter or equivalent ▪ Independent engineer reports ▪ Documentation of begun construction ▪ If not safe harbored, adherence to PW&A requirements (e.g., certified labor payroll, apprentice's hour logs, etc.) ▪ Documentation substantiating eligibility for bonus credits (e.g., location of project for energy community, supplier cost data and steel/iron certifications for domestic content)
Quantification – *For ITCs, was the project cost basis properly calculated, and were only eligible expenses included? For PTCs, was the correct rates utilized and is production verifiable?*	▪ Third-party cost certification for ITCs ▪ Audited financials ▪ Operating reports
Recapture* - *Was the project abandoned, foreclosed, or sold within five years of the placed in-service date?*	▪ Documentation on credit worthy off-taker for entire recapture period, structure of debt, sufficient property/casualty insurance, and site control
Counterparty Risk – *If losses are realized, can buyer collect damages against seller/credit worthy entity?*	▪ Financials of sellers and any guarantor ▪ Tax credit insurance

**Risk category specific to Section 48 ITCs and not applicable to Section 45 PTCs.*

Tax Credit Monetization

General Process - Buyer

PHASE 1 Tax Modeling – Quantifying Tax Appetite	▪ Quantify the organization's tax appetite based upon forecasted tax positions through a tax modeling exercise. ▪ Federal transferable credits are treated as General Business Credits (GBC). Tax modeling should identify how purchased credits would flow through a forecasted return. ▪ Tax limitations or other attributes may exist that limit the overall tax appetite such as Foreign Tax Credits, OECD Pillar Two, other GBCs (R&D), and the overall General Business Credit limitation. ▪ Tax modeling may focus on the current year only or consider the expanded 3-year carryback window.
PHASE 2 Define Timing and Credit Type Considerations	▪ Align the organization's cash flow availability for purchase of federal transferable credits. Cash set aside for tax estimates may be reallocated. ▪ Based upon tax appetite and cash flow needs, determine strategy on a quarterly versus annual purchase of credits. ▪ Consider larger Q4 purchase if carryback for a refund is under consideration ▪ Transferable tax credits represent either Production Tax Credits (PTC) or Investment Tax Credits (ITC).
PHASE 3 Credit Sourcing	▪ Identify available credits based upon earlier tax appetite parameters determined in Phase 2. Credits may also be sourced by credit type, technology, location, or risk management (i.e., seller provided indemnification or tax credit insurance). ▪ Prior to project summary reports being shared for management review/consideration, Non-Disclosure Agreements are executed.
PHASE 4 Letter of Intent/ Diligence	▪ Pending management review, a Letter of Intent is provided to the seller of available credits expressing formal interest. Deposit upon execution of LOI may be required for exclusivity. ▪ Upon acceptance by seller, diligence performed on the underlying merit of the credit to assess risk (e.g., was the project developed in an appropriate structure to avoid Investment Tax Credit Recapture). ▪ For insured credits, discretion may be considered on the level of diligence as insurance providers perform their own diligence for underwriting purposes.
PHASE 5 Credit Transfer Agreement and Post-Closing	▪ Credit transfer agreement negotiated and reviewed with an organization's preferred counsel. ▪ Purchased credits become available to offset an organization's applicable tax liability ▪ Seller provides buyer with a copy of the transfer election statement included on buyer's tax return along with underlying documentation required to report the credit transfer to the IRS. ▪ Pay for tax credits (upon execution and/or through installment payments).

Credit Monetization Example

STEP 1:

Company A plans an investment of $100 million in energy storage technology that meets the PW&A requirements. The investment generates an investment tax credit.

Description	Tax Credit Calculation
Eligible Project Costs	$100,000,000
Section 48 ITC Credit Rate	30%
Tax Credit to Monetize	**$30,000,000**

STEP 2:

Company B plans to purchase Company A's $30 million investment tax credit.

Description	Tax Credit Value
Company B's Eligible Credit Value	$30,000,000
Purchase Price Ratio	$0.93 per $1.00
Company B's Net Purchase Price	$27,900,000
Company B's Cash Tax Savings	**$2,100,000**

Key Notes:

- *Tax Credit purchases must be made in cash.*
- *The tax benefit of an eligible credit purchased by the buyer for less than face value is excluded from gross income.*
- *Purchased credits may be utilized in lieu of estimated tax payments.*
- *Tax credit buyer may commercially negotiate that the credit seller reimburse diligence and legal fees upon close.*