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Fund Formation and Credit Transfers: Monetizing Tax Credits Using Partnerships

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Section 6418 of the Internal Revenue Code (as added by the Inflation Reduction Act of 2022) allows an eligible taxpayer that qualifies for certain clean energy tax credits, including investment tax credits and production tax credits, to transfer those credits to a third-party buyer in exchange for cash. To be able to transfer those credits, a registration number is required. In December 2023, the Internal Revenue Service launched an online registration tool to obtain those registration numbers.

Partnerships can transfer or acquire credits under Section 6418. Proposed regulations published in June 2023 contain rules specific to credit transfers where a partnership is the transferor or transferee. In general, if a partner in a transferee partnership is not subject the passive activity rules (i.e., corporations and other institutional investors), then that partner can take full advantage of purchased credits. While buyers of credits cannot sell the acquired credits, the allocation of acquired credits does not violate this limitation, and credits will be allocated based on who pays for them.

Because of the flexibility of the rules related to transferee partnerships, we expect there to be a number of partnerships created to acquire clean energy tax credits under Section 6418 and enable institutional investors to rely upon those managing these partnerships to diligence and negotiate credit acquisition and manage post-acquisition requirements. The Fund Group at Holland & Hart LLP is well positioned to assist in all facets of this process, including formation of (or investment in) special purpose funds, negotiation of the purchase of tax credits, diligence surrounding the purchased credits, and compliance with statutory and regulatory requirements associated with formation of these funds and the receipt and allocation of the credits.

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