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IRS Considers Allowing Individuals to Purchase Clean Energy Tax Credits, but Buyer Beware [Video]

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The IRS recently stated it would consider allowing individuals to purchase renewable energy tax credits from companies. Ordinarily, passive loss rules apply to buyers, preventing individuals from utilizing tax credits in areas in which they are not actively involved against the individual's active income. Even if the IRS promulgates rules allowing individuals to purchase the credits, individual buyers would still have the same issues facing current renewable energy tax credit purchasers.

Currently, the Inflation Reduction Act of 2022 (IRA) allows companies to sell tax credits to third parties for cash. The proceeds are not treated as income to the seller. Likewise, the purchase is not treated as a deduction for the buyer. The IRA allows different tax credits to be sold:

- Renewable energy, nuclear, or other zero-emission electricity tax credits
- Carbon sequestration tax credits
- Clean hydrogen and clean transportation fuel production tax credits
- Wind, solar, and storage component or processing tax credits
- Critical mineral refining or recycling tax credits
- Tax credits for a new factory or re-equipping a factory that makes or recycles products for the green economy and reduces greenhouse gas emissions at an existing facility
- Tax credits for an electric vehicle or other clean fuel charging station installation in a low-income or rural area

On June 14, the IRS issued proposed regulations providing additional guidance, which may be found here. Under the IRA and the proposed regulations, the tax credit buyer is responsible to the IRS if the tax credits are later disallowed or reduced by the IRS.

Further, the IRS may impose penalties equal to 20% of the disallowed tax credits. Since the buyer is the party that is claiming the tax credits on its tax return, the IRS likely would require the buyer to pay interest and other penalties on the prior-year tax adjustments. Given the large amount of tax credits available, the recapture and penalties associated with the recapture could potentially be massive. Penalties are avoidable if the buyer does careful diligence, but that does not mitigate against the risk of recapture in later years.

Buyers have already begun addressing these issues by requiring indemnities and seller guarantees to guard against the risk their credits are later denied on audit. However, these indemnities will likely also be extensive. The indemnity would need to require compensation to the buyer for both the lost money the buyer paid for the credits and any money paid to the IRS. Whatever party ends up stuck with the tax credits has the potential to suffer greatly. If the IRS wishes to extend the ability for individuals to purchase tax credits, some protections should be considered.

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