

IRS and Treasury Publish Final Regulations for Section 48 Investment Tax Credits

On December 12, 2024, the United States Department of the Treasury and the Internal Revenue Service (“IRS”) published final regulations (the “Final Regulations”) regarding the energy credit available under Section 48 of the Internal Revenue Code (the “Section 48 Credit(s)” and the “Code”). The Final Regulations primarily clarify and modify rules for determining whether investments in energy property are eligible for the tax credit, and otherwise adopt the proposed regulations that were released by the IRS in November 2023 (“Proposed Regulations”).

The Section 48 Credit is a federal investment tax credit designed to incentivize investment in certain types of clean energy technologies, including solar, wind, geothermal, fuel cells, energy storage, biogas and combined heat and power systems. The credit available for a taxable year is generally calculated as the percentage of the basis of each energy property placed in service during the taxable year. The base credit is six percent of the qualified investment, which can be increased to 30 percent if prevailing wage and apprenticeship requirements are met. Additional bonus credits of up to 10 percent are available if the project meets domestic content requirements or if the energy project is located in an energy community, respectively. The credit is available for projects that begin construction before January 1, 2025.

The Final Regulations are effective from December 12, 2024, and will apply to projects that begin construction before January 1, 2025, and are placed in service during a tax year beginning after the effective date. Taxpayers may also elect to apply the Final Regulations for projects that are placed in service after December 31, 2022.

EXECUTIVE SUMMARY

The Final Regulations primarily clarify and modify rules for determining whether investments in energy property are eligible for the Section 48 Credit, and otherwise adopt the Proposed Regulations.

We note the following key points:

- the Final Regulations expand and clarify the definitions for specific types of energy property, including qualified biogas property, energy storage technology, hydrogen energy storage property and thermal energy storage property, and provide guidance on the integral parts of such property;
- the Final Regulations provide further clarity on the definition of a unit of energy property and provide illustrative examples; and
- the Final Regulations increase the number of common factors required to group multiple energy properties as a single energy project from two to four, and allow the taxpayer flexibility as to when the determination of a single energy project is made.

The following sets forth a summary of a number of the key changes under the Final Regulations.

Specific Energy Property Definitions

QUALIFIED BIOGAS PROPERTY

Under Section 48 of the Code, energy property includes qualified biogas property. The Final Regulations clarify that qualified biogas property is defined as a system that converts biomass into a gas that consists of not less than 52 percent methane by volume and captures such gas for sale or productive use, and includes any property that is part of such system that cleans or conditions such gas. The Final Regulations confirm that integral parts of a qualified biogas property include waste feedstock collection systems, landfill collection systems and mixing or pumping equipment.

Although qualified biogas property generally may not capture biogas for disposal via combustion, the Final Regulations provide that combustion in the form of flaring will not disqualify a qualified biogas property, provided that the primary purpose of the qualified biogas property is sale or productive use of biogas.

The Proposed Regulations provided that the methane content requirement for the project is measured at the point at which gas exits the biogas production system. The Final Regulations require measurement when the biogas exits the qualified biogas property.

CO-LOCATED ENERGY STORAGE TECHNOLOGY

The Final Regulations provide that energy storage technology (and its integral parts) is generally eligible for the Section 48 Credit. Commenters to the Proposed Regulations requested clarification regarding the treatment of energy storage technology co-located or otherwise shared with a facility that is otherwise eligible for certain other federal tax credits. The Final Regulations confirm that energy storage technology qualifies for the Section 48 Credit if it meets the Section 48 requirements, even when it is co-located with or shared by a facility eligible for credits under Section 45 (*i.e.*, renewable energy production tax credits), Section 45V (*i.e.*, clean hydrogen production credits) or Section 48 (*i.e.*, renewable energy investment tax credits) of the Code.

HYDROGEN ENERGY STORAGE PROPERTY

The Proposed Regulations included hydrogen energy storage property as energy storage technology, but only if the property is used to store hydrogen exclusively for energy production and not for other purposes, such as the production of end products (*e.g.*, fertilizer). The Final Regulations remove this limitation.

The Final Regulations clarify that property that is an integral part of hydrogen energy storage property includes, but is not limited to, hydrogen liquefaction equipment and gathering and distribution lines within a hydrogen energy storage property. The preamble to the Final Regulations also clarifies that equipment used to store hydrogen carriers (including ammonia and methanol) is not eligible for the Section 48 Credit.

THERMAL ENERGY STORAGE PROPERTY

The Final Regulations clarify that thermal energy storage property includes equipment involved in adding, or transferring, already-existing heat from one medium to the storage medium (*e.g.*, heat pumps), but does not include equipment that transforms other forms of energy into heat (*e.g.*, combustion or electric resistance). The Final Regulations establish a safe harbor, specifying that thermal energy storage property capable of supplying heating or cooling for a minimum of one hour qualifies for the Section 48 Credit.

COMPONENTS OF ENERGY PROPERTY

The Proposed Regulations defined a unit of energy property to mean all functionally interdependent components of property owned by the taxpayer that are operated together and that can operate apart from other energy properties within a larger energy project. The Final Regulations clarify that, in applying this definition to a solar energy property, a unit of solar energy property consists of all the solar panels that are connected to a common inverter, or connected to a common electrical load if a common inverter does not exist. The preamble to the Final Regulations also provides an example that a large, ground-mounted solar energy facility may comprise one or more units of energy property.

Single Energy Project Test

The Final Regulations clarify that, for the purposes of the prevailing wage and apprenticeship requirements, the domestic content bonus credit and

energy community bonus credit, the term “energy project” is defined as a project consisting of one or more energy properties that are operated as part of a single project. The Proposed Regulations required only two factors out of the following seven factors to be present during the construction phase to treat multiple energy properties owned by a taxpayer as a single energy project:

1. “The energy properties are constructed on contiguous pieces of land;
2. The energy properties are described in a common power purchase, thermal energy, or other off-take agreement or agreements;
3. The energy properties have a common intertie;
4. The energy properties share a common substation, or thermal energy off-take point;
5. The energy properties are described in one or more common environmental or other regulatory permits;
6. The energy properties are constructed pursuant to a single master construction contract; or
7. The construction of the energy properties are financed pursuant to the same loan agreement.”

Because of this lower threshold, commenters to the Proposed Regulations expressed concerns that energy properties that would not commonly be considered a single energy project would be unintentionally grouped together under the Proposed Regulations (e.g., where multiple projects are built pursuant to the same construction contract), creating administrative problems and making it difficult to claim other potential credits. The Final Regulations require the presence of at least four factors, granting taxpayers additional flexibility to satisfy requirements for increased credits.

Under the Proposed Regulations, energy properties are grouped as a single energy project if the relevant factors are met at any point during construction. The Final Regulations allow the taxpayer to choose whether to assess the factors during construction or during the taxable year in which the energy properties are placed in service, providing taxpayers more flexibility in grouping their energy properties depending on the applicable ownership structure during construction and when the project is placed in service.

The Final Regulations also clarify that an energy project will be deemed placed in service when the final energy property within the energy project is placed in service.

Measurement Standards for Nameplate Capacity

Eligibility for Section 48 Credits depends on the relevant energy property’s nameplate capacity, or maximum rate of sustained output. Commenters to the Proposed Regulations stated general concerns regarding the measurement methods included in the Proposed Regulations for nameplate capacity, and the Final Regulations include several modifications that clarify these calculations, including the following:

- **THERMAL ENERGY STORAGE:** Because demonstrating the nameplate capacity of thermal energy storage property may be technically impractical for some types of thermal energy storage property, the Final Regulations provide an option to use the nameplate capacity of the equipment that delivers thermal energy when nameplate capacity for thermal energy storage property is not available. In addition, the Final Regulations provide that the maximum thermal output an entire project is capable of delivering at any given moment does not take into account the capacity of redundant equipment that is not operated when the system is at maximum output during normal operation.
- **DIRECT CURRENT:** The Final Regulations also provide a new rule for energy properties that generate electricity in direct current, allowing the taxpayer to choose to determine the maximum net output of each energy property that is part of the energy project by using the lesser of (i) the sum of the nameplate generating capacities within the unit of energy property in direct current, which is deemed the nameplate generating capacity of the unit of energy property in alternating current; or (ii) the nameplate capacity of the first component of property that inverts the direct current electricity generated into alternating current.

Interconnection Property

The Final Regulations allow a taxpayer to claim a Section 48 Credit for interconnection property for an energy property within a larger energy project, provided that such claim is limited to energy

property that has a maximum net output of five megawatts. The Final Regulations clarify the five-megawatt limitation's application in cases in which an energy property's nameplate capacity differs from the maximum output provided in the interconnection agreement. The Final Regulations provide an example that even if a taxpayer has an interconnection agreement with the utility that allows for an output greater than five megawatts, the taxpayer may include the costs the taxpayer paid or incurred for qualified interconnection property to calculate the Section 48 Credits for each of the energy properties that has a maximum net output of not greater than five megawatts. In the case of electrical energy storage property, the five megawatt limitation is determined by using the energy storage property's maximum net output as its nameplate capacity.

The Final Regulations also confirm that tangible property required to modify and upgrade transmission or distribution systems beyond the point of interconnection would be considered qualified interconnection property and eligible for inclusion in basis for purposes of the Section 48 Credit.

Ownership Rules

The Final Regulations retain the rules introduced in the Proposed Regulations regarding fractional ownership of projects. A taxpayer that owns components sufficient to comprise "a unit of energy property" may claim a Section 48 Credit even if another taxpayer owns certain other components of that energy property.

The Proposed Regulations included power conditioning and transfer equipment as energy property, and the Final Regulations clarify that such equipment is considered an integral part of an energy property (as opposed to a component of a unit of energy property) and provide a nonexclusive list of types of power conditioning equipment.

Recapture Rules

In the Proposed Regulations, the tax credit buyers were solely responsible for complying with the prevailing wage requirements. However, the Final Regulations make it clear that both the seller and the buyer of the tax credits share the risk of losing the Section 48 Credit *pro rata* if the prevailing wage requirements are not met.

Conclusion

Although the Section 48 Credits will be replaced by the "technology neutral" investment tax credits from January 1, 2025, the Final Regulations will remain relevant for taxpayers with projects that began construction prior to January 1, 2025, and who elect to apply the new regulations. In addition, many principles of the Final Regulations are likely to be relevant to the "technology neutral" investment tax credits going forward.

Application of the Final Regulations will need to be determined on a case-by-case basis, and taxpayers will need to carefully consider how the Final Regulations will impact any ongoing projects (if they choose to apply them) and any projects that are due to commence construction before January 1, 2025.

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