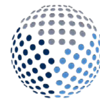

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Transferable Energy Tax Credits Can Reduce Tax Sting on Taxable Carveouts—Past or Future

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Houlihan Lokey is pleased to present its tax insights on the Inflation Reduction Act of 2022 (the "IRA" or the "Act"), available here. This insight is the third in a series from Houlihan Lokey's M&A Tax team diving into areas of the IRA that may impact clients. See the other insights here.

Introduction

Taxable carveout transactions in which companies sell a business division or subsidiary often result in significant tax bills to sellers. They also represent arguably the best opportunity for a taxpayer to maximize the value of purchased tax credits following the passing of the IRA.

In a taxable carveout transaction, the seller can reasonably estimate its cash tax burden during the transaction process with the expectation that estimated or actual tax payments will be due in near proximity to the transaction closing. Sellers also typically have the liquidity to pay their tax burdens on transactions immediately after close. For these reasons, carveout sellers can position themselves to mitigate a portion of their cash tax nearly simultaneously with the close of the transaction through the purchase of tax credits while also supporting other initiatives, such as investing in sustainable energy sources. For taxpayers who have completed large dispositions (and paid extraordinary tax liabilities) within the prior three years, opportunities exist to recover a portion of their previously remitted taxes by purchasing tax credits and carrying them back to prior years for a refund.

Companies contemplating a taxable carveout sale, or those who have completed one in the prior three years, should ensure they consider the benefits of purchasing tax credits post-IRA.

Opportunity Overview

The IRA dramatically expanded and enhanced incentives for private investment in clean energy. The IRA restores and enhances the production tax credit (PTC), now available for solar as well as wind and other qualified energy resources, and the investment tax credit (ITC). It adds an enhanced tax credit for solar and wind components manufactured in the U.S., and new credits for clean hydrogen, zero-emission nuclear energy, stand-alone battery storage, and sustainable aviation fuel, among others.

As of January 1, 2023, the IRA also enables a groundbreaking shift by allowing a one-time sale of clean energy credits by project developers to unrelated purchasers for cash. Developers of renewable energy with excess tax credits sell credits at a discount to their tax-saving potential, thus allowing purchasers with tax liabilities to lock in a near-immediate return on investment while also serving ESG-related initiatives.

Most sales are anticipated to be completed at a price that is 90%–93% of the value of the tax credit. The shorter the period between payment and use, the more the buyer may need to pay for the credits.

Companies facing substantial one-off tax bills—such as those arising from a taxable carveout—can now strategically leverage a one-time transferable tax credit purchase. This approach allows buyers to offset federal tax liabilities and gain a unique advantage in managing unforeseen tax burdens.

Tax Credit Transferability Overview

Tax credit guidance issued on June 14, 2023, establishes key principles for tax credit transfers:

- Eleven types of credits can be sold.
- Buyers must pay in cash.
- A transferred credit cannot be retransferred.
- The credit buyer is treated as the taxpayer regarding the purchased credits, necessitating consideration of recapture risks and potential mitigations through insurance and indemnities.
- Cash payments are nondeductible by the credit purchaser and the discount between cost and value is nontaxable.
- The deadline to sell credits for a given year is the due date for the annual return, plus extensions, providing a clear time frame for transactions.
- The tax credit purchaser can reduce quarterly estimated tax payments in years that it has purchased or intends to purchase credits.

Tax Credit Utilization Overview

Purchased credits are utilized in the first taxable year ending with or after the taxable year of the credit seller. For example, in situations in which both the buyer and seller operate on a calendar year ending December 31, 2023, the seller would be expected to generate the credit during 2023 and the buyer would be able to buy the credit prior to filing its 2023 tax return for application against its 2023 income tax liability.

Purchased credits can be carried back three years, although buyers must adhere to certain restrictions, including applying credits to the current year first and then to the earliest applicable date. This may involve the filing of amended returns.

Credits are transferred with a straightforward tax credit transfer agreement and a jointly filed transfer election statement. Purchased tax credits can be used to reduce income tax by up to 75% each year. A credit buyer to which the corporate alternative minimum tax or OECD Pillar Two applies can still lower its tax burden below the 15% threshold with no consequences under the corporate alternative minimum tax and only a small reduction in the ETR ratio under Pillar Two.

Summary

Corporate taxpayers hoping to manage their effective tax rates despite large one-time tax bills as a result of a recent transaction can reduce their federal income tax liability through the purchase of transferable tax credits for renewable energy. Taxpayers who have engaged in taxable separation planning over the past three years, recognizing large built-in gains, can strategically employ available cash (or borrow) for transferable tax credits to offset tax liability or recover taxes already paid.

In addition to the tangible tax savings, companies looking to meet certain ESG and/or sustainability goals should consider adopting a tax credit purchase strategy to align with those overarching objectives.

How We Can Help

Houlihan Lokey has a proven record of successfully making markets for tax assets and providing creative capital market solutions. Houlihan Lokey has assembled a cross-functional team specializing in corporate finance and taxation focused on tax credit monetization. We are actively collaborating with market participants to maximize tax credit opportunities for our clients.

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