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## **Proposed Guidance on Investment Tax Credits for Clean Hydrogen Production Facilities**

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On December 22, 2023, Treasury and the Internal Revenue Service released proposed regulations on tax credits under the Inflation Reduction Act relating to hydrogen. The proposed regulations address two tax credits for clean hydrogen production facilities. The first, discussed in our prior [blog post](#), is the section 45V credit for the production of clean hydrogen (the “45V PTC”), which provides a production tax credit for hydrogen produced over a ten-year period (up to \$3 per kg of hydrogen). The second credit, which this post addresses, is the investment tax credit under section 48(a)(15) (the “hydrogen ITC”), which the taxpayer can elect in lieu of the 45V PTC. The hydrogen ITC provides a credit equal to a percentage of the cost of certain qualified property included in the clean hydrogen production facility. Unlike the 45V PTC, which is available over a 10-year period as the taxpayer produces hydrogen, the full amount of the hydrogen ITC is available for the taxable year in which the facility is placed in service.

### **Eligibility for and Amount of the Hydrogen ITC**

To be eligible for the hydrogen ITC, the facility must be placed in service on or after January 1, 2023, the taxpayer must elect the hydrogen ITC on the taxpayer’s Federal tax return for the taxable year in which the facility is placed in service, and the facility must meet requirements similar to those for the 45V PTC. Once an election to claim the hydrogen ITC is made with respect to a facility, it is irrevocable and binding on all owners of that facility. Similar to the 45V PTC, the amount of the hydrogen ITC varies based on the lifecycle greenhouse gas (GHG) emissions associated with the hydrogen production—the cleaner the hydrogen, the greater the credit. Compliance with the prevailing wages and apprenticeship requirements increases the hydrogen ITC by 5x. Notably, however, the “domestic content” and “energy community” bonus multipliers under section 48 are not available for purposes of the hydrogen ITC. In addition, if the facility includes carbon capture equipment, the taxpayer generally cannot claim both the hydrogen ITC and the section 45Q credit for carbon capture and sequestration. The table below shows the four tiers of hydrogen ITC rates to which a taxpayer is entitled based on the rate of GHG emissions in producing the hydrogen.

Tier	Lifecycle GHG Emissions Rate (kg of CO <sub>2</sub> e/kg of H <sub>2</sub> )	Applicable Percentage (%)	Compliance with PW&A* Requirements	Available Tax Credit (%)
1	0 – 0.45	6%	Yes	30%
2	0.45 – 1.5	2%	Yes	10%
3	1.5 – 2.5	1.5%	Yes	7.5%
4	2.5 – 4	1.2%	Yes	6%

\*Prevailing Wages & Apprenticeship

As with the 45V PTC, for purposes of establishing the lifecycle GHG emissions, the proposed regulations permit the taxpayer to use “Energy Attribute Certificates” (or “EACs”) if three pillars are satisfied: (i) incrementality (or additionality), (ii) temporal matching, and (iii) deliverability. Our prior post on the 45V PTC discusses these three pillars in greater detail. Broadly, they are intended to ensure that hydrogen production is generated by “new” or “incremental” electricity-generating facilities in the same region as the hydrogen production facility, and that the electrical and hydrogen production occur during the same timeframe (a requirement that has already drawn fire from some corners for being too stringent).

In addition to the eligibility requirements discussed above, the taxpayer must obtain an annual verification report for the taxable year in which the election is made and for each taxable year thereafter during the recapture period (which, as discussed below, is the five-taxable-year period beginning on the first day of the taxable year after the taxable year in which the facility is placed in service). The report must be signed by a qualified verifier with certain accreditations and include information prescribed by the proposed regulations (e.g., a statement attesting to the lifecycle GHG emissions rate of the hydrogen produced at the facility for the taxable year to which the report relates).

## Recapture

In certain events, the hydrogen ITC can be “recaptured,” which can increase the taxpayer’s tax liability for the year in which the recapture occurs. There are several different types of recapture that can apply to the hydrogen ITC.

### “Typical” ITC Recapture

Because the hydrogen ITC is an investment tax credit, the typical rules for recapture of investment tax credits apply. Thus, if the facility is disposed of or ceases to qualify for the hydrogen ITC within the five-year period after it is placed in service, a portion of the credit will be recaptured under Section 50(a).

In addition to recapture under Section 50(a), if the taxpayer claims an enhanced tax credit for complying with the prevailing wage and apprenticeship requirements, the enhanced credit is subject to recapture pursuant to Section 48(a)(10)(C) during the five-year period beginning on the date the facility is placed in service. However, unlike recapture under Section 50(a), taxpayers are provided an option to pay a penalty to ‘cure’ the failure to comply with the prevailing wage and apprenticeship requirement in lieu of reducing the claimed credit.

### **Recapture if Lifecycle GHG Emissions are Greater Than Expected**

The hydrogen ITC is determined based on the lifecycle GHG emissions that the facility produces in the taxable year in which it is placed in service. In a later year during the recapture period, however, all or a portion of the credit may be recaptured if the lifecycle GHG emissions are greater than expected or the taxpayer fails to comply with the annual verification requirements (a “recapture event”). Increased emissions trigger recapture only if the increase is large enough to cause the facility to fall within a higher emissions “tier” (e.g., a GHG emissions increase of 0.15 kg of CO<sub>2</sub>e per kg of hydrogen would not be a recapture event if the facility initially produces 0.2 kg of CO<sub>2</sub>e per kg of hydrogen because the facility would still be within Tier 1). In addition, this type of recapture applies only if the recapture event occurs within a five-taxable-year period beginning on the first day of the taxable year after the taxable year in which the facility was placed in service (the “recapture period”). For example, if a taxpayer placed the facility in service in June 2023, recapture could apply if the recapture event occurs in 2024, 2025, 2026, 2027, or 2028.

To determine the recapture amount, the proposed regulations effectively allocate 20% of the credit to each of the five taxable years within the recapture period. If a recapture event occurs in one of those years, a maximum of 20% of the credit can be recaptured in respect of that particular year. The next year during the recapture period is tested anew, with another possible 20% recapture if there is a recapture event in that year (e.g., the higher emissions rate continues or the taxpayer again fails to satisfy the verification requirements). Whether the full 20% will be recaptured in a particular year depends on the type of recapture event. In the case of a failure to satisfy an annual verification requirement, the full 20% for the year is recaptured. For recapture based on higher emissions, however, the recapture amount depends on how much the emissions increased. In that instance, less than 20% will be recaptured as long as the facility’s increased GHG emissions in that year would still fall within one of the four hydrogen ITC tiers.

### **The 45V PTC vs. the Hydrogen ITC**

A variety of factors may be relevant in determining whether to elect the hydrogen ITC in lieu of the 45V PTC. As one example, aside from the differences in timing between the credits, the hydrogen ITC election may trigger the application of certain other rules that generally apply only to investment tax credits (see, for example, our [prior post](#) discussing certain considerations relevant to investment tax credits in the context of flow-through entities with tax-exempt investors). In addition, while ‘taxable’ entities cannot receive direct pay for the hydrogen ITC, they are eligible for direct pay with respect to the 45V PTC for a five-taxable-year period beginning with the year in which the facility is placed in service. Ultimately, any decision as between the 45V PTC and the hydrogen ITC should be carefully considered by the taxpayer and its advisors.

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