

ALERT MEMORANDUM

Proposed Regulations on Section 45Z Clean Fuel Production Credit Issued

February 11, 2026

Introduction

Proposed regulations under section 45Z, which incentivizes domestic production of low-carbon fuels, were issued on February 3, 2026 by the U.S. Department of the Treasury and the Internal Revenue Service (“IRS”) (REG-121244-23). The proposed regulations follow the IRS’s initial guidance on the topic in Notice 2025-10, with some variations, and implement key amendments from the 2025 budget reconciliation act known as the “One Big Beautiful Bill Act” (“OBBA”).

Background

Section 45Z provides a tax credit for low-emission transportation fuel produced domestically after December 31, 2024 and sold by December 31, 2029. To earn the credit, a taxpayer must produce transportation fuel at a facility in the United States that is not claiming other tax credits, be registered under section 4101 at the time of production, and sell the fuel to an unrelated person in a qualified sale. For this purpose, a “qualified sale” means a sale to an unrelated person for use in the production of a fuel mixture, for use in a trade or business, or for a retail sale.

In July 2025, the OBBBA imposed new North American feedstock sourcing requirements and restrictions on access to credits by “prohibited foreign entities,” a term which includes entities with ties to China, North Korea, Russia, or Iran.

Key Provisions of Proposed Regulations

— *Qualified sales: Sales Through Intermediaries and Related Parties*

In response to industry comments to Notice 2025-10, the proposed regulations provide that “qualified sales” include a sale to an unrelated person that subsequently resells the fuel in its trade or business. This provision clarifies that sales to intermediaries such as wholesalers and dealers are permitted, resolving a key question unanswered by Notice 2025-10, which many industry participants interpreted as limiting qualifying sales to end users. Additionally, a producer is treated as selling to an unrelated person if a related person ultimately sells the fuel to an unrelated person.

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— *Suitable Use Standard: Actual Use Not Required*
A fuel is “suitable for use” under the proposed regulations if it has practical and commercial fitness for use as a fuel in a highway vehicle or aircraft, or if it can be blended into such a fuel mixture. The proposed regulations clarify that actual use as a highway or aviation fuel is not required for a fuel to satisfy the “suitable for use” standard. For example, diesel fuel that has practical and commercial fitness for use as a fuel in a highway vehicle but is ultimately used as marine fuel would be considered suitable for use and qualify as transportation fuel.

— *Producer of Renewable Natural Gas Eligible for Section 45Z Credit*

For renewable natural gas, the producer eligible to claim the section 45Z credit is the person that processes untreated sources of alternative natural gas to become interchangeable with fossil natural gas. Compression of renewable natural gas that is already interchangeable with fossil natural gas is not considered production and does not qualify for the credit. Accordingly, a renewable natural gas producer that delivers the renewable natural gas to a pipeline remains eligible for the credit even if another person later removes the renewable natural gas from the pipeline, compresses it further, and sells it.

— *North American Feedstock Sourcing Limitation*

Implementing the OBBBA domestic feedstock requirement, the proposed regulations provide that transportation fuel produced after December 31, 2025 must be derived exclusively from feedstock produced or grown in the United States, Mexico, or Canada. A feedstock is considered foreign feedstock if it originates from a source located outside the United States, Canada, or Mexico, or if it is purchased from an aggregator located outside these countries.

— *Foreign Entity Restrictions*

The proposed regulations implement the OBBBA prohibited foreign entity rules by providing that “specified foreign entities” are not eligible for section 45Z credits for taxable years beginning

after July 4, 2025, and “foreign-influenced entities” are not eligible for section 45Z credits for taxable years beginning after July 4, 2027. “Specified foreign entities” generally include taxpayers organized in or controlled by taxpayers in China, North Korea, Russia, or Iran. “Foreign-influenced entities” generally include taxpayers who have issued significant debt or equity or entered into certain contracts with specified foreign entities.

— *Anti-Abuse Provisions*

The proposed regulations include anti-abuse rules intended to prevent credit churning or wasteful production, providing that no section 45Z credit is available if the primary purpose of producing and selling fuel is to obtain the credit in a wasteful manner (such as discarding, disposing of, or destroying the fuel without productive use), based on all facts and circumstances. To prevent double counting, the regulations exclude from the definition of “transportation fuel” any fuel “produced from a fuel for which a section 45Z credit is allowable,” ensuring only the first transportation fuel in a production chain qualifies.

— *Emissions Rate Determination*

To determine a fuel’s emissions rate, a taxpayer must use the annual emissions rate table, determined by the emissions table in effect for the taxable year in which the fuel is produced. Taxpayers who cannot use the emissions rate table can obtain a provisional emissions rate determination. For fuels produced after December 31, 2025, the emissions rate must not be less than zero, with an exception for fuels made from animal manure. Additionally, any emissions attributable to indirect land use change are excluded from emissions rates for fuels produced after that date.

Public Comments and Hearing

The Treasury and IRS are accepting public comments, written or electronic, until April 6, 2026. A public hearing on the proposed regulations is scheduled for May 28, 2026, at 10 a.m. Eastern Time.

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