**Submitted via the Federal eRulemaking Portal** August 14, 2023

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Daniel Werfel
Commissioner
Internal Revenue Service
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Washington, DC 20224

William Paul
Principal Deputy Chief Counsel
Internal Revenue Service
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**Re: Recommendations for Guidance Regarding Elective Payment of Applicable Credits and Transfer of Certain Credits**

Dear Assistant Secretary Batchelder, Commissioner Werfel, and Principal Deputy Chief Counsel Paul,

Please find enclosed recommendations for guidance regarding elective payment of applicable credits and transfer of certain credits under the Inflation Reduction Act.

The Tax Law Center at NYU Law is a public interest initiative that seeks to improve the integrity of the tax system. Our staff includes tax law experts with experience in tax administration, private practice, and the tax legislative process.

Roger Baneman currently serves as an advisor to the Natural Resources Defense Council. He is a retired tax partner of the law firm of Shearman & Sterling LLP. Early in his career, he served in Treasury's Office of Tax Legislative Counsel, first as attorney-advisor and then as Acting Associate Tax Legislative Counsel.

We would be pleased to discuss these recommendations with you or your staff.

Sincerely,

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Enclosure

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## 1 Introduction

This comment analyzes selected issues arising in the implementation of sections 6417 and 6418 of the Internal Revenue Code (the "Code"),[1] which were added to the Code by Pub. L. No. 117-169 (known as the Inflation Reduction Act or "IRA"). The IRA extended, expanded, or created over twenty tax credits and deductions meant to encourage the adoption and deployment of clean technologies.

The IRA creates new mechanisms to broaden access to these tax incentives, as compared to tax deductions and nonrefundable tax credits. This comment focuses on two key provisions broadening access: (1) the elective payment of applicable credits under section 6417 ("elective pay"), and (2) the transfer of eligible credits under section 6418 ("transferability").

Notice 2022-50 requested general comments on elective pay and transferability provisions, and the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") have already received more than 200 comments on these provisions in response. Treasury and the IRS published two Notices of Proposed Rulemaking on June 14, 2023, one with proposed regulations implementing section 6417 (the "Proposed Elective Pay Regulations") and one with proposed regulations implementing section 6418 (the "Proposed Transferability Regulations").[2] We commend Treasury for prioritizing this critically needed guidance. We offer some comments to assist you as you craft final rules.

This comment letter focuses on issues where tax legal expertise is especially relevant to determining the bounds of regulatory authority, the administrability of regulatory decisions or options, and how the climate tax provisions interact with other provisions of the Code or tax system more broadly.

The Tax Law Center (the "Center") is a public interest initiative that seeks to improve the integrity of the tax system. Our staff includes tax law experts with experience in tax administration, private practice, and the tax legislative process.

The climate tax provisions of the IRA involve "tax expenditures" that seek to encourage specific kinds of activities. In such areas of tax, the Center seeks to ensure that the statute is faithfully interpreted and applied. To the extent there is authority to choose between or among different implementation approaches, the Center prefers approaches that most efficiently (per dollar of revenue cost) achieve the policy purposes of the law; ensure sound tax administration and compliance; and do not have adverse impacts on other areas of the tax system.

The Center submits this comment as part of our Climate Tax Project, which is a two-year commitment to offer technical input on implementation of the IRA's climate tax provisions and support rigorous engagement from public interest stakeholders. The Center's Climate Tax Project staff attorneys have government, law firm, and accounting firm experience in energy tax and other relevant areas of tax law including in administrative law, policy analysis, federal tax

[1] Any references to the "Code" or "section" are to the Internal Revenue Code of 1986 unless otherwise noted.

[2] Temporary regulations regarding the pre-filing registration requirements for certain tax credit elections were published on the same day, but our comments generally focus on the two proposed rulemakings.

controversies, and exempt organizations. The project relies on the input of other Center staff with deep expertise in other areas of tax law, including partnership tax.[3] The project also relies on the Center's extensive networks of public interest minded tax practitioners and stakeholders to ensure that our work is informed by a current understanding of relevant market and practice considerations.

Roger Baneman currently serves as an advisor to the Natural Resources Defense Council. He is a retired tax partner of the law firm of Shearman & Sterling LLP. Early in his career, he served in Treasury's Office of Tax Legislative Counsel, first as attorney-advisor and then as Acting Associate Tax Legislative Counsel.

## 2 Executive Summary

We first set out in Part 3.1 analysis of the purposes of the IRA and its monetization provisions that should inform implementation decisions. There is little official legislative history for the IRA climate tax provisions, but their purpose is evident in the text, structure, and relationship to other provisions of the IRA and in the significant differences in their design as compared to prior approaches to monetizing energy-related tax credits in the Code. Given this context, we provide specific recommendations for implementation approaches.

Our principal recommendations with respect to the Proposed Elective Pay and Transferability Regulations are set out in Parts 4 and 5, and are as follows:[4]

- **Improve access to Investment Tax Credits in the territories**. Currently, section 50(b)(1) (and cross-referencing provisions) precludes entities from claiming investment tax credits ("ITCs") under sections 48 and 48E and credits under sections 30C, 45W, 48C with respect to property predominantly used in the territories. As a result, the territories only have access to elective payment and transferability for production tax credits ("PTCs"), which is inconsistent with the policy goals of the IRA. Just as Treasury clarified that the definition of applicable entity includes territory governments in the Proposed Elective Pay Regulations, we recommend that Treasury exercise that same authority in the final regulations by issuing a rule clarifying that entities are eligible for elective pay and transferability for all IRA credit property used in the territories.[5]

  This recommendation could be adopted using the broad regulatory authority in sections 6417(h) and 6418(h) and is consistent with Treasury's approach in other IRA

[3] Contributing Tax Law Center Climate Tax Project staff: Senior Attorney Advisor and Director of the Climate Tax Project Mike Kaercher, Attorney Advisor Taylor Cranor, and Attorney Advisor Kyle Sweeney. Other contributing Tax Law Center Staff: Partnership Taxation Senior Advisor John Rooney, Attorney Advisor Sophia Yan, and Tax Law and Policy Fellow Grace Henley.

[4] Our recommendations and comments are generally offered in the same order in which the issues are addressed in the preambles to the Proposed Elective Pay Regulations and the Proposed Transferability Regulations. Topics that are not addressed specifically in the preambles are addressed at the end of the relevant sections. We address the Proposed Elective Pay Regulations before turning to the Proposed Transferability Regulations.

[5] We offer recommendations regarding access to ITCs in the territories through elective pay in Part 4.1. We offer recommendations regarding access to ITCs in the territories through transferability in Part 5.2.

implementation contexts. This exercise of authority is especially appropriate with respect to the territories because the federal government has a unique relationship with the territories that is reflected in a series of legal regimes. This includes prior access to federal tax credits and tax administration practices and relationships. The territories have also been disproportionately burdened by the effects of climate change, experience higher rates of poverty than any State, and have often been denied access to critical federal programs. Exercising Treasury's regulatory authority to ensure full access for ITCs earned in the territories would address a series of access and equity challenges that lawmakers have, in the past, sought to address using various monetization mechanisms.

We also set out potential approaches to address compliance without precluding territories from accessing these credits.

- **Consider allowing section 6417 elections for credits earned through partnerships with applicable entity partners**. The Proposed Elective Pay Regulations provide that partnerships with applicable entity partners are not applicable entities—and therefore cannot generally access elective pay for any part of investments made through the partnership—unless the partnership itself is making the elective pay election. Treasury's interpretation of the phrase "determined with respect to such entity" in section 6417(a) would preclude the possibility of looking through to partners or shareholders to determine whether credits can be accessed through elective pay. We set out the statutory authority for potential alternative approaches. In Part 4.2, we recommend that Treasury modify the Proposed Elective Pay Regulations so that applicable entities can form partnerships with other applicable entities without jeopardizing their ability to make a section 6417 election. In Part 4.3, we recommend that Treasury consider allowing mixed partnerships (i.e., partnerships with applicable entity and non-applicable entity partners) to make section 6417 elections on behalf of their applicable entity partners. Allowing applicable entity partners to access elective pay would further the purposes of the IRA by allowing for partnership arrangements that could help applicable entities cover capital needs, diversify risk, and fill gaps in expertise. We believe there is limited additional risk of fraud for partnerships wholly comprised of applicable entities in particular, and we believe the pre-filing registration system and other tools can be used to enhance administrability and reduce the risk of fraud.
- **Provide additional relief for elective payment elections**. The Proposed Elective Pay Regulations state that a section 6417 election is irrevocable and must be made on the filer's original return, not an amended return. The Proposed Elective Pay Regulations helpfully offer a transitional automatic paperless six-month extension for entities for which no Federal income tax return is otherwise required. We recommend that Treasury build on this provision and provide additional relief to filers who have acted in good faith to add or correct an elective pay election within a reasonable timeframe after the deadline has passed. To that end, Treasury should reconsider the wholesale prohibition on access to Treas. Reg. §§ 301.9100-1 through 301.9100-3 (together the "Filing Extension Regulations") and should allow filers to request relief under Treas. Reg. § 301.9100-2(b). Treas. Reg. § 301.9100-2(b) provides an automatic six-month extension to make or correct statutory elections on timely filed returns, which should provide a filer who

timely files their return a six-month extension to make or correct any section 6417 elections.

- **Allow certain entities to claim elective payment on credits purchased under section 6418**. The Proposed Elective Pay Regulations prohibit tax credit transferees from making an election under section 6417 with respect to transferred credits ("transferee elective pay") because, according to the preamble, credits must be "determined with respect" to the entity claiming elective pay. However, the statute clearly contemplates transferee elective pay in at least some exceptional circumstances, and completely prohibiting transferee elective pay would be at odds with the statutory text and structure. Exercising the statutory authority to provide exceptions for certain transferees posing low compliance risk would be most consistent with how Treasury has implemented other parts of the Code and the IRA. We therefore recommend that Treasury modify the Proposed Elective Pay Regulations to allow transferees who possess certain characteristics indicating a low risk of fraud and abuse, and a meaningful connection to the project, to make a 6417 election. Those transferees would include State and local governmental entities; quasi-governmental entities, such as state housing finance agencies and green banks; public power entities who are also purchasing power from the transferor; certain mission-relevant tax-exempt entities, such as tax-exempt Community Development Financial Institutions ("CDFIs"); and entities purchasing section 48C and 48(e) credits.
- **Prioritize guidance for applicable entities seeking exceptions to the domestic content requirements when claiming the generation credits**. Beginning in 2024, the PTCs under sections 45 and 45Y and the ITCs under sections 48 and 48E will start to phase out and will eventually become unavailable to applicable entities whose projects do not meet the domestic content requirements. To plan projects properly, applicable entities must understand the rules governing the statutory exceptions to the domestic content requirements so that they have certainty about the amount of credit they can expect to receive. We recommend that Treasury prioritize issuing clear guidance on the domestic content elective pay requirements and exceptions. Implementation of the IRA is an enormous undertaking, and Treasury has prioritized much of the most important guidance**,** including issuing the Proposed Elective Pay and Proposed Transferability Regulations. Going forward, Treasury should additionally consider prioritizing guidance implementing domestic content exceptions for applicable entities, given that (1) these requirements go into effect for projects commencing construction in 2024, (2) these rules ultimately relate to whether the credits can be accessed at all, rather than whether a bonus is available, and (3) project planning may be delayed while these rules are pending. We understand that prioritizing this guidance may mean delays in issuing other important guidance.

  We also discuss how the novelty of the domestic content provisions in the tax system context create some significant challenges for the IRS and Treasury in administering the domestic content exceptions. We suggest some approaches Treasury should consider to implement clear and administrable exceptions and provide the market and policymakers with information about which domestic supply gaps are driving the domestic content exceptions being claimed and granted.

- **Develop strong taxpayer services in consultation with entities and communities with the greatest barriers to access**. A key goal of the IRA is to reach new market participants to broaden access to climate-related tax incentives. To deliver on this goal, the IRA and other legal frameworks and administrative commitments require the IRS to continue considering equity and access in its build-out of taxpayer assistance, especially with respect to underserved communities and filers likely to face barriers to access. The IRS should employ a range of strategies to accomplish this, including leveraging community partnerships, expanding efforts to proactively consult communities with the greatest barriers to access, and building on the IRS's existing outreach and education initiatives. We also recommend the IRS develop tools and strategies to effectively deliver services. Examples include providing plain-language educational materials, offering culturally appropriate and language-accessible customer service support, providing liaisons for particular stakeholder groups to reduce barriers to information access, and developing streamlined methods for filers to connect with relevant information.
- **Reconsider statutory authority for not applying passive activity limitations to credit transferees, consider interactions with other regulatory decisions when determining whether to use this authority, and revisit as necessary**. Although the approach of the Proposed Transferability Regulations is within Treasury's authority, it would also be within Treasury's authority, alternatively, to treat a credit transferee as not engaged in a trade or business as a result of the transferee's purchase and claim of the credits, and therefore, not limited under section 469. The most important consequence of treating credit transferees as not limited by section 469 is that it would permit individuals to offset active income with purchased credits. We see the fundamental trade-off as follows: allowing individuals to broadly participate as credit purchasers would potentially allow for thicker markets, providing more tax capacity for the credits to be absorbed and reducing spreads. However, it also raises important concerns including potential fraud and abuse, as individuals, particularly those who are less affluent, may have less ability to perform due diligence on the credits and may become targets of fraudulent schemes.

  This issue cannot be evaluated in a vacuum. It is interconnected with regulatory approaches taken in other areas (including the approach to elective pay through partnerships, transferee elective pay, and other regulatory options). We encourage Treasury to think holistically about its approach both to compliance and to the risk that tax capacity could become a deployment barrier during the long-term life of these credits. We also encourage Treasury to think about the best ways to address this potential bottleneck, with changes to the application of passive activity rules being one potential tool.

# 3 Background

## 3.1 Context and Purpose of Monetization Provisions

There is little official legislative history for the IRA climate tax provisions generally or the monetization provisions specifically. Nevertheless, important clues to the purposes of the monetization provisions are provided by their text, structure, relationship to other provisions of

the IRA, and significant differences in their design compared to prior approaches to monetizing energy-related tax credits in the Code.

When the IRA passed the House, then-Chairman Neal emphasized that the "legislative intent" of the statute's clean energy tax credits was to "unleas[h] clean energy deployment, in line with President Biden's pledge of a 50-52 percent reduction" in net emissions by 2030.[6] Treasury has stated that the policy goals of these provisions in the IRA include "accelerating the deployment of clean energy to lower energy costs for American families, strengthening the U.S. industrial base, securing [clean] energy supply chains in collaboration with [US] allies and partners, and creating jobs and economic opportunity."[7] The structure of Subtitle D of Title I ("Energy Security") of the IRA, including how it alters and differs from prior monetization regimes, indicates how lawmakers intended the transferability and elective pay regimes to support the broader purposes of the IRA climate tax provisions, while managing fraud, tax compliance, and administration challenges.

### 3.1.1 Structure and History

The IRA's monetization provisions are the latest in a series of steps that policymakers have taken to expand access to energy-related tax benefits and respond to challenges that they have faced in doing so. This history, as well as the IRA's changes relative to prior law, indicate that the monetization provisions are intended to:

- **Expand access to market players that could be particularly important to achieve the goals of these incentives**. These include, especially, governmental entities (including, specifically, territories) and tax-exempt entities (including public power and rural electric coops), small developers and projects, and new market entrants accessing the tax credits.
- **Increase the share of the value of credits going to incentivize desired activities rather than being absorbed by market intermediaries**.
- **Reduce the risk that recession dramatically restricts the availability and effectiveness of these incentives**.
- **Limit uncertainty and transaction and administration costs** that are particular barriers to access for newer, smaller, and less-sophisticated market participants.
- **Reduce fraud and non-compliance risk with specific reliance on novel mechanisms and authorities**.

The pre-IRA Code, and now the IRA, show that lawmakers have deliberated on and reacted to these considerations by incrementally expanding access to tax incentives for emissions reduction technologies over time while also adopting novel approaches to minimizing compliance risks.

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[6] 168 Cong. Rec. H7664 (August 12, 2022) (statement of Representative Neal) ("Many provisions of Subtitle D [the clean energy subtitle of the IRA] remain substantially similar to those that the House developed and passed [in the Build Back Better Act].").

[7] Press Release, U.S. Dep't of Treasury, Remarks by Assistant Secretary for Tax Policy Lily Batchelder on Implementation of the Inflation Reduction Act's Clean Energy Provisions (March 22, 2023) ("Remarks by Assistant Secretary Batchelder").

Congress has for decades used the tax system to provide incentives to adopt technologies to reduce emissions.[8] These provisions were historically structured as non-refundable tax credits, deductions, and cost recovery provisions.

Such provisions could not initially be directly accessed by entities that have little or no federal income tax liability. These include, in particular, governmental and tax-exempt entities, small developers and projects, and new market entrants. Access hurdles for these potential market players may be especially detrimental to the policy goals of the underlying tax incentives. Governmental entities may be especially likely to undertake potential projects that are designed to have local community benefit, or that are important for emissions reduction goals if they are able to access the incentive value. This might include, for example, projects creating energy infrastructure with spillover public benefits (such as projects that enhance charging infrastructure or grid resiliency) or projects that efficiently deliver or are connected to other public goods provided by governmental entities, such as projects connected to local economic development, housing, education, and health initiatives. Governmental entities could also be an especially important potential player in the most underserved communities. Public power entities and rural electric coops together serve over a quarter of American households, and so their access to credits can have significant deployment and access impacts. The TVA serves another 10 million people. Likewise, small developers and projects and new market entrants may be regarded as a potential source of important forms of technology or business innovation, or as important for deployment furthering equity goals.

Markets, with some assistance from IRS guidance, addressed these access problems in a limited way through the development of complex "tax equity" structures, including partnership flips, inverted leases, and sale-leaseback arrangements.[9] But these still left in place barriers to potentially important market participants. Tax equity investments involve significant fixed costs, including the cost of legal counsel for structuring complex deals. These fixed costs, along with the return the investor receives, effectively reduce the credit's subsidy of the desired activity.[10] In addition, tax equity investment appetite fluctuates with macroeconomic conditions; when there is

[8] Perhaps the most significant clean energy tax credit provisions prior to the IRA were the PTC under section 45 and the ITC under section 48. The PTC for wind and other technologies was first enacted in 1992. *See* Energy Policy Act of 1992, Pub. L. No. 102-486, § 1914, 106 Stat. 2776, 3020-23 (1992). A PTC for advanced nuclear facilities was added, as section 45J, in 2005. *See* Energy Policy Act of 2005, Pub. L. No. 109-58, § 1306, 119 Stat. 594, 997-99 (2005). The original ITC for solar and other "energy property and equipment using energy resources other than oil or natural gas" was first enacted in 1978. *See* Molly F. Sherlock, Cong. Rsch. Serv., IF10479, The Energy Credit or Energy Investment Tax Credit (ITC) (April 23, 2021) (discussing the history of section 48).

[9] Under a partnership flip structure, a developer forms a partnership with a tax equity investor and sells the energy project to the partnership for fair market value. The tax equity investor takes a disproportionate interest (for example, 99 percent) in the partnership, and once the investor achieves a target yield, the structure "flips" so that the equity investor's interest in the partnership is significantly reduced. Under the safe harbor for PTC flips set forth in Rev. Proc. 2007-65, the equity investor must retain at least 5 percent interest post-flip during the existence of the partnership, while the developer's interest is limited to 95 percent. Partnership flips typically include an option for the developer to later purchase the project from the partnership which, under the safe harbor, must be on a date that is at least 5 years after the facility is placed in service. *See* Keith Martin, *Solar tax equity structures*, Project Finance (December 14, 2021). *See also* Peter Richman, *Direct Pay, Transferability, and the Corporate AMT,* Tax Notes Federal (April 24, 2023).

[10] Mark P. Keightley et al., Cong. Rsch. Serv., R45693, Tax Equity Financing: An Introduction and Policy Considerations 4 (April 17, 2019).

a recession and corporate tax liability falls, tax equity investor demand drops.[11] Finally, "investors typically prefer larger projects and established technologies; as a result, it is usually more difficult for smaller projects and newer technologies to find financing."[12]

Prior to the IRA, the many climate-related tax incentives in the Code and the regulations implementing them bear the imprint of lawmakers' attempts to respond to some of these remaining challenges. For example, section 1603 of the American Recovery and Reinvestment Act of 2009 ("ARRA") was policymakers' response to concerns during the financial crisis and Great Recession that tax equity investment would dry up, pinching the pipeline of new projects. ARRA included a temporary program (the "1603 Program"), allowing filers to seek grants in lieu of the ITC under section 48.

And, while Treasury has published guidance allowing various tax equity approaches, lawmakers have also over time adopted more direct routes to expand monetization of tax credits through transfer-like mechanisms, including in some cases expanding access to these monetization tools specifically to certain public entities. Lawmakers amended the original section 179D energy efficient commercial buildings deduction to allow certain governmental entities to allocate the deduction to "the person primarily responsible for designing the property" without the need to establish a partnership with that person.[13] The section 30D clean vehicle credit has also long permitted certain entities to allocate credits to another party to the transaction.[14] In addition, Congress amended the advanced nuclear PTC under section 45J in 2018 to allow certain public entities to allocate the credit to certain project partners.[15] This may be the closest antecedent to section 6418, given that, under both provisions, the transferee "shall be treated as the taxpayer for purposes of this title with respect to such credit (or such portion thereof)."[16]

The IRA represents the latest, most robust response to these challenges, building upon some of the incremental changes that lawmakers have made in the past to increase access, particularly for governmental entities, smaller developers and projects, and new market entrants—especially in recessions. To address the risk that increased access may increase risks of non-compliance (including fraud), the IRA also introduces novel administrative and compliance tools.

Under the IRA, certain tax indifferent entities, as well as filers producing or placing into service certain clean energy technologies, are eligible for "full elective pay."[17] For most of the general

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[11] *See, e.g., id.* at 12 ("During the Great Recession, falling corporate tax liabilities reduced investor demand for credits . . .").

[12] *See* Richman, *supra* note 9 (citing Brian R. Murphy & Dorian Hunt, *Tax Equity in a Direct-Pay World*, Tax Notes Federal (February 21, 2022)).

[13] Section 179D(d)(3).

[14] *See* section 30D(f)(3) (2021), *amended by* section 30D (2022).

[15] *See* Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 40501(b), 132 Stat. 64, 153-54 (2018).

[16] *See* sections 45J(e) and 6418(a).

[17] This comment uses the term "full elective pay" to describe the elective pay regime as applied to applicable entities described in section 6417(d)(1)(A). These entities are eligible for elective pay on all twelve credits described in section 6417(b) for the entire credit (including the entire stream of credits in the context of PTCs). This comment

business credits ("GBCs") included in the IRA, filers who are not eligible for full elective pay are, instead, permitted to transfer credits to an unrelated party.

The IRA includes a novel mechanism to address the potential for fraud and abuse. Specifically, "[a]s a condition of, and prior to, any amount being treated as a payment which is made by an applicable entity under subsection (a) [of section 6417], the Secretary may require such information or registration as the Secretary deems necessary for purposes of **preventing duplication, fraud, improper payments, or excessive payments** under [section 6417].").[18] As the Assistant Secretary for Tax Policy noted, "[t]he pre-filing process will help prevent improper payments to fraudsters like criminal syndicates."[19]

Additionally, for transferability, lawmakers put the transferee of credits on the hook when a credit is not properly determined.[20] This exposure should motivate a credit buyer to undertake due diligence. Alternatively, credit buyers may use market mechanisms to shift risk to other parties, such as through indemnification provisions or insurance products related to credit clawbacks. So, to the extent that the discount on the nominal value of transfer tax credits represents some privatization of compliance cost through diligence costs or adoption or shifting of risk by the transferee, this may be appropriate given the IRA's compliance goals. However, to the extent that any discount represents capture by tax credit purchasers of part of the underlying credit value, or transaction costs with no compliance benefits, it will reflect inefficient loss of tax revenue that does not flow towards subsidizing the desired investment activities.

### 3.1.2 Implementation Approach Given Structure and History

Given the IRA's statutory context and history, implementation of the IRA's monetization provisions should avoid replicating the very challenges that these provisions—and successor monetization provisions—sought to address. This means that, within statutory authority and all else equal, implementation of the monetization provisions should seek to:

- **Ensure that elective pay is implemented in accordance with its purpose of extending credit access to key potential market participants**.
- **Ensure that credit transfer markets are implemented in ways that both increase the efficiency and effectiveness of the underlying subsidy and make it more resistant to recessions**. This generally will mean decisions that reduce the portion of the subsidy (discount on the nominal value of the credit) that is captured by credit purchasers, tax equity investors, or market intermediaries rather than going into the underlying investment. It also means considering and attempting to reduce the extent to which transfer markets are

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uses the term "partial elective pay" to describe the elective pay regime as applied to electing entities eligible for elective pay for part of the PTC or credit stream, as described in sections 6417(d)(1)(B)-(D) (related to clean hydrogen, carbon capture storage, and advanced manufacturing).

[18] Section 6417(d)(5) (emphasis added); *see also* section 6418(g)(1) (emphasis added).

[19] U.S. Dep't of Treasury, Remarks by Assistant Secretary Batchelder, *supra* note 7.

[20] *See* sections 6418(a) (treating the transferee as the taxpayer with respect to purchased credits) and 6418(g)(2) (applying excessive credit transfer rules to the transferee).

concentrated and dependent on tax equity investors and transfer credit purchasers whose tax liability and tax credit appetite is likely to contract substantially during recessions.

- **Reduce transaction and compliance costs (but consistent with achieving compliance)** as these are likely to increase barriers to potential market players utilizing the monetization provisions in ways that are detrimental to the equity goals of the IRA.
- **In seeking to achieve the IRA's and Code's critical compliance and tax integrity purposes, rely first and most heavily on the specific statutory tools provided to address compliance concerns**: the novel pre-filing registration regime, the ability to leverage private transfer markets in ways that increase compliance, and the ability to devote IRA funding to building out administrative systems and approaches that support compliance. Pre-filing registration, in particular, is the tool that Congress explicitly provided to ensure compliance and combat fraud and should be the primary compliance mechanism. In its initial iteration, the pre-filing registration system appears to be focused on reducing the risk of fraud, such as claims related to non-existent projects. Over time, this system can be iteratively improved to further encourage compliance, while balancing the potential administrative burden on filers. For example, the pre-filing registration system could be used to further reduce risks related to the determination of basis for ITCs, and the risk of fraud against transferees.

  Simply denying access to monetization for certain market participants or projects, when that access is authorized by statute, should be the last resort rather than the first tool that the Administration uses to address compliance risks.
- **Consider interactions among regulatory decisions and retain flexibility to monitor and make adjustments**. Our comment sets out the statutory authority allowing Treasury to make a series of decisions that could contribute to thick credit utilization and transfer markets. Well-functioning markets are important to the access and deployment purposes of the IRA, including the goal of bringing in new market entrants, ranging from cities to small businesses. For example, the statute permits Treasury to allow transferee elective pay in exceptional circumstances, adopt an alternative treatment of certain partnerships, and adopt an alternative approach to interpreting and applying the passive activity rules. While each of these options has its own merits, they are also interdependent. If Treasury adopts an approach to one of these issues that promises to thicken the relevant market, it may choose to take a less forward approach on another of these issues where there may be heightened fraud or other compliance concerns.

  There is also interdependence between the IRA's market thickening goals and its compliance goals. If Treasury makes strong use of the regulatory authority under sections 6417(d)(5) and 6418(g)(1) to set up robust pre-filing registration and other compliance mechanisms, this could reduce the pressure to adopt positions that might contract markets or reduce access for historically excluded projects.

  In other words, Treasury should think holistically about the issues, considering the tradeoffs between the access, deployment, and compliance goals of the monetization regime. The overall aim is to achieve a regulatory package that, as a whole, appropriately balances these goals. This holistic approach is supported by statute due to the highly interdependent nature of the credits and the interdependent elective pay, credit transfer, and tax equity markets, the broad implementation authorities in the law, and the goals of the IRA.

Furthermore, the scale of these credits is uncertain, and transferability and elective pay are novel. It is impossible for Treasury to currently know exactly how the markets will respond or where the bottlenecks will arise. Therefore, Treasury should maintain flexibility to adjust its implementation approaches over time in response to new information about how the markets develop. Other relevant factors that will change over time include the build out of the pre-filing registration system and the Strategic Operating Plan ("SOP") for tax compliance as a whole.

So, while Treasury will try to strike the right balance as an initial matter, it should recognize, where appropriate, that it is choosing among various possible implementation approaches authorized by statute to achieve the purposes of the IRA. Treasury should actively monitor the relevant markets and evaluate the impact of its implementation choices and, if necessary, make adjustments within the scope of authority if the goals and purposes of the IRA are not being best met by the initial regulatory settings.

For example, consistent with an iterative approach, if Treasury determines that certain entities including State and local governments pose the least risk of fraud in the context of transferee elective pay, Treasury could use entities as a test case by offering them an exception for transferee elective pay and then later consider other potential classes.

This iterative approach is accommodated by the broad grant of regulatory authority in the monetization provisions. It is appropriate for Treasury to explicitly use this broad authority to justify its regulatory decisions, and revisit those decisions over time, given the very difficult task at hand: balancing multiple purposes of a law with a highly interconnected statutory framework that those purposes are often in tension with. Citing this regulatory authority in the preamble may also enhance the durability of the regulations to potential legal challenges, offering additional evidence of statutory authority to adopt the rules that are within a broader scope of authority.[21]

Finally, **Treasury should not interpret lack of stakeholder input requesting broader access as conclusive evidence that such broader access is not necessary to achieve the access, deployment, and equity goals of the IRA**. Some of the stakeholders that would be able to access IRA tax credits would be engaging with the federal tax system (or its tax credit aspects) for the first time, and for this and other reasons, currently have limited capacity to participate in the notice and public comment process. Treasury has laudably adopted novel and proactive outreach to engage a broad stakeholder community in IRA climate tax rulemaking. And it has devoted substantial resources to the implementation of sections 6417 and 6418. But many entities will still not have the capacity to engage robustly in notice and comment, and Treasury should understand comments in that light.

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[21] For example, we would recommend citing the broad regulatory authority under section 6417(h) to describe why entities described in sections 527 and 528, which by statute "shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes" are not eligible for elective pay. Similarly, we recommend citing the broad regulatory authority (in addition to statutory analysis) as additional support for the general prohibition on transferee elective pay.

## 3.2 Overview of Sections 6417 and 6418

The IRA creates various monetization provisions. The two most prominent are elective pay and transferability—new Code sections 6417 and 6418, respectively.[22]

Section 6417 generally allows a State, Indian tribal, territory, or local government, certain public utilities and coops, or a tax-exempt entity (and, for a small subset of credits for a five-year period, all filers) to receive the credit amount as a direct cash payment from the federal government.[23] More specifically, it permits an "applicable entity" to make an election with respect to any "applicable credit."[24] If that election is made, the relevant credit is reduced to zero, and the applicable entity is treated as making a payment of tax imposed by subtitle A, in the amount of the credit. This mechanism creates a potential overpayment of tax, giving Treasury the authority needed under section 6402 to cut a check to the filer to the extent the filer has made an elective pay election resulting in payments (deemed or actual) in excess of its federal income tax liability. Most applicable entities have no income tax liability, and so the check will be the full elective pay amount under section 6417. In general, the payment of tax is deemed to be made on "the later of the due date (determined without regard to extensions) of the return of tax for the taxable year or the date on which such return is filed."[25] For governmental entities that are not required to file a return, the payment of tax is deemed made on "the later of the date that a return would be due under section 6033(a) if such government or subdivision were described in that section or the date on which such government or subdivision submits a claim for credit or refund (at such time and in such manner as the Secretary shall provide)."[26] These dates determine when the deemed payment (and thus the potential overpayment) occurs, and the IRS may not refund the relevant credit amounts prior to the overpayment date.

Section 6417(c) describes certain mechanics of elective pay when the relevant property is held by a partnership or S corporation. "In the case of any applicable credit determined with respect to any facility or property held directly by a partnership or S corporation, any election under subsection (a) shall be made by such partnership or S corporation."[27] As discussed below, the overall effect and limitations of this provision are unclear, but procedurally the election is to be made at the entity level.

The statute creates two separate classes of entities claiming elective pay: elective pay for (mainly) certain tax-indifferent entities, called "applicable entities," and elective pay for other filers. Applicable entities are eligible for full elective pay, meaning they can make an elective

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[22] Other monetization provisions include the expanded and modified dealer transfer provision for new electric vehicles, *see* section 30D(g), new dealer transfer provision for used electric vehicles, *see* section 25E(a), and the expanded allocation provision for certain tax-exempt entities for the energy efficient commercial buildings deduction *see* section 179D(d)(3).

[23] "Applicable entity" is defined in section 6417(d) and "applicable credit" is defined in section 6417(b).

[24] Section 6417(a). Applicable credits include the credits available under sections 30C, 45, 45Q, 45U, 45V, 45W, 45X, 45Y, 45Z, 48, 48C, and 48E.

[25] Section 6417(d)(4)(B).

[26] Section 6417(d)(4)(A).

[27] Section 6417(c)(1).

pay election for any of the twelve "applicable credits" described in section 6417(b). The statute lists the following applicable entities as eligible for full elective pay:

- any organization exempt from the tax imposed by subtitle A,
- any State or political subdivision thereof,
- the Tennessee Valley Authority,
- an Indian tribal government (as defined in section 30D(g)(9)),
- any Alaska Native Corporation (as defined in section 3 of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m)), or
- any corporation operating on a cooperative basis which is engaged in furnishing electric energy to persons in rural areas.[28]

To ensure these entities can claim credits even though most are not subject to federal tax, section 6417(d)(2) determines credits without regard to sections 50(b)(3) and (4)(A)(i) when an elective pay election is made and treats the relevant property as used in the trade or business of the applicable entity. Section 50(b)(3) and section 50(b)(4)(A)(i) bar organizations exempt from the income taxes in Chapter 1 of subchapter A and governmental entities, respectively, from determining credits under sections 48 through 48E. Without this modification, elective pay would be functionless for these entities, at least with respect to ITCs.

Entities that are not listed above, such as for-profit developers and manufacturers, are eligible for "partial elective pay." Partial elective pay applies to just three credits: (1) the clean hydrogen PTC under section 45V, (2) the carbon oxide sequestration credit under section 45Q, and (3) the advanced manufacturing PTC under section 45X.[29] Partial elective pay is available only for five years, rather than for the full credit period. After the five-year period, transferability is available for these filers.

Section 6417 elections are generally irrevocable and must be made by the due date for the return including extensions for time (or at the time determined by the Secretary, in the case of a governmental entity).[30] The election is generally made on a facility-by-facility basis. For the tax-indifferent applicable entities, the election is made for the entire stream of credits, in the context of a PTC.[31] For entities eligible for partial elective pay, the elective pay election applies to the whole five-year period.[32]

Sections 45, 45Y, 48, and 48E (the "generation credits") impose a haircut on elective payments for generation credits if the underlying facility or property has a maximum output of 1 megawatt

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[28] Section 6417(d)(1)(A).

[29] *See* section 6417(d)(1)(B)-(D). While the carbon sequestration credit does not necessarily relate to "production," its multi-year structure and placement in the Code reflect the fact that is it structured more like a PTC than an ITC.

[30] Section 6417(d)(3).

[31] *See* sections 6417(d)(3)(B)-(E).

[32] *See* section 6418(d)(1)(D)(ii)(I), (d)(3)(C)(i)(II)(aa), and (d)(3)(D)(i)(III)(aa).

or more and does not meet domestic content requirements.[33] To satisfy the domestic content requirements, all of the steel or iron in a facility or energy project must be manufactured domestically, and 40 percent of the total costs of manufactured products in the facility or energy property must be from domestically produced manufactured products.[34]

Elective payments for generation credits stemming from projects that begin construction in 2024 will receive a 10 percent haircut if the project fails to meet the domestic content requirements and has an output of 1 megawatt or more (making the applicable percentage 90 percent).[35] Elective payments for 1 megawatt or greater projects not meeting the domestic content elective pay requirements are subject to a haircut of 15 percent if the underlying projects begin construction in 2025 and are eliminated if the projects begin construction in 2026 or later.[36]

Except as described above, rules similar to section 50 apply to elective pay. Most importantly, this means that the recapture rules of section 50(a) and the basis coordination rules of section 50(c) apply to credits for which elective pay is elected. Separate from the section 50 recapture rules, 120 percent of any excessive elective pay credits (generally, improperly claimed credits) shall be recaptured (100 percent if the filer demonstrates reasonable cause to the satisfaction of the Secretary).[37]

In order to ensure integrity and deter fraudulent or inflated credits, Congress provided Treasury the authority to "require such information or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments."[38] The statute further provides broad authority to issue regulations and guidance to "carry out the purposes of" section 6417.[39]

Filers that are not eligible for elective pay are eligible for transferability under section 6418. Section 6418(a) allows an "eligible taxpayer" to make an election with respect to any "eligible credit." When this election is made, the credit can be sold to another taxpayer. The buyer must be

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[33] Sections 45(b)(10), 45Y(g)(12), 48(a)(13) (cross-referencing section 45(b)(10)), and 48E(d)(5) (cross-referencing section 45Y(g)(12)).

[34] The threshold to meet the manufactured products requirement will increase over time for the clean electricity production credit, topping out at 55 percent for projects beginning construction in 2027. *See* section 45Y(g)(11)(C)(i). The threshold will remain at 40 percent for the investment tax credit, production tax credit, and clean electricity investment credit. *See* sections 45(b)(9)(C)(i), 48(a)(12)(B) (cross-referencing section 45(b)(9)(B)), and 48E(a)(3)(B) (cross-referencing section 48(a)(12)). There is a lower threshold for manufactured products in offshore wind facilities. *See* sections 45(b)(9)(C)(ii), 45Y(g)(11)(C)(ii), 48(a)(12)(B) (cross-referencing section 45(b)(9)(B)), and 48E(a)(3)(B) (cross-referencing section 48(a)(12)).

[35] Sections 45(b)(10) and 48(a)(13).

[36] Sections 45Y(g)(12) and 48E(d)(5).

[37] Section 6417(d)(6).

[38] Section 6417(d)(5).

[39] Section 6417(h).

unrelated,[40] and the consideration must be for cash.[41] The credit transfer must be made at the entity level, "not later than the due date (including extensions of time) for the return of tax for the taxable year for which the credit is determined," and no subsequent transfers are permitted after the first transfer.[42]

There are some similarities to the elective pay regime, including the mechanics for partnerships and S corporations,[43] the broad regulatory authority,[44] the specific authority to require relevant advance registration or information,[45] and the 120 percent recapture of excessive credits,[46] subject to reasonable cause relief. There are also some differences. First, the scoping of elective pay and transferability are meant to complement each other. Transferability is meant to apply to any filer who is not eligible for full elective pay.[47] In other words, every filer should have access to either transferability or elective pay (but not both, with limited exceptions) with respect to an eligible credit. Second, the transferability regime does not allow credits to be determined without regard to the rules under section 50(b)(3) or (4)(a)(i). This is because entities impacted by those provisions in section 50 are intended to be covered by elective pay. Third, transferability allows credits to be sliced more finely than elective pay. For streams of credits under the PTC, the transferability provision allows for annual elections.[48] This reflects the fact that a for-profit filer may eventually have tax capacity to take the credit on their own return, as well as the fact that the filer may want to sell PTCs on an annual basis once the PTC amount is actually known.[49] Finally, the commercial clean vehicle credit is eligible for elective pay, but not for transferability.[50]

[40] Section 6418(a) (adopting related party definitions from sections 267(b) and 707(b)(1)).

[41] Section 6418(b).

[42] Section 6418(e).

[43] Section 6418(c).

[44] Section 6418(h).

[45] Section 6418(g)(1).

[46] Section 6418(g)(2).

[47] *See* section 6418(f)(2).

[48] Section 6418(f)(1)(B)(ii).

[49] As discussed more below, the Proposed Transferability Regulations clarify that transferable credits may be sliced vertically, meaning the credit portion reflects a proportionate share of bonus credits, and sold to multiple transferees *See* Prop. Treas. Reg. § 1.6418-1(h); Prop. Treas. Reg. § 1.6418-2(a)(2).

[50] *See* sections 6417(b)(6) and 6418(f)(1)(A).

### 3.3 Overview of Proposed Guidance

### 3.3.1 Proposed Elective Pay Regulations

The Proposed Elective Pay Regulations address issues raised by Treasury in Notice 2022-50 and the public in response to that Notice. At a high level, the proposed regulations clarify which entities qualify as applicable entities, including whether territory governments and flow-through entities may be applicable entities; provide guidance on the manner in which entities can claim elective pay, including the appropriate return to be used and time for filing; outline the applicability of existing statutory limitations on the use of the IRA credits, including sections 49 and 469; address whether applicable entities may purchase credits and seek elective payment for those credits; and set forth certain pre-filing registration requirements for entities seeking elective pay. Below, we briefly summarize the proposed rules, focusing in large part on the topics that are the subject of this comment.

#### 3.3.1.1 Applicable Entities

The proposed regulations clarify the types of entities that qualify under each category of applicable entity set forth in section 6417(d)(1)(A). For the category consisting of "any organization exempt from the tax imposed by subtitle A," the proposed regulations narrow the category to only include organizations exempt from tax under section 501(a) of the Code and governments of US territories (including agencies and instrumentalities thereof). For governments of US territories, the proposed regulations clarify that such entities are still subject to section 50(b)(1), which precludes an entity from claiming ITCs (but not PTCs) on credit property used outside the US. For the applicable entity category consisting of States and political subdivisions, the proposed regulations include the States (including the District of Columbia ("DC"))[51] and agencies and instrumentalities thereof. The proposed regulations use the term "electing entities" to describe filers who make an election under section 6417(d)(1)(B), (C), or (D) (relating to clean hydrogen, carbon capture and sequestration, or the advanced manufacturing PTC).

Regarding entities formed by an applicable entity or electing filer, the proposed regulations provide that the activities of a disregarded entity owned by an applicable entity will be attributed to that applicable entity. This means that an applicable entity may claim elective pay in cases where its disregarded entity or entities holds the applicable credit property.

For partnerships and S corporations, however, the proposed regulations take a different position. In cases where a partnership or S corporation invests in applicable credit property, the partnership or S corporation will generally not be treated an applicable entity, and in most cases,

[51] Under section 7701(a)(10), the term "State" generally includes the District of Columbia, and the Proposed Elective Pay Regulations follow this general rule.

will not be eligible for elective pay.[52] This is because, according to the preamble, the best interpretation of the statutory language, which states that an applicable entity may make an elective pay election with respect to any applicable credit "determined with respect to such entity," is that applicable credit property must be held directly by an applicable entity, not by a flow-through entity.

The proposed regulations provide an alternative, however, by allowing applicable entities to co-own applicable credit property "through an ownership arrangement treated as a tenancy-in-common or pursuant to a joint operating arrangement that has properly elected out of subchapter K of chapter 1 of the Code (subchapter K) under section 761."[53] Under this type of arrangement, the proposed regulations would allow applicable entities to make an elective pay election for applicable credits in proportion to their ownership interest in the underlying applicable credit property.[54]

The preamble also requests comments on the other types of entities that should qualify as applicable entities, including whether federal agencies should be considered applicable entities and more generally, whether additional clarification is needed regarding the status of consolidated groups consisting of Alaska Native Corporations or rural co-ops as applicable entities.

#### 3.3.1.2 Manner of Making the Election and Pre-Filing Registration

The proposed regulations provide that elective pay elections should be made on an applicable entity or electing filer's annual tax return along with Form 3800 (for claiming general business credits).[55] That annual return must be the original return that an electing entity would normally file, and it must be filed no later than the due date.[56] The proposed regulations do not allow a section 6417 election to be made on a revised or amended return, leaving no relief for returns that are not timely filed.[57] For entities that do not normally file an annual tax return with the IRS, the proposed regulations require those entities to file either the annual tax return they would file

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[52] The Proposed Elective Pay Regulations create a framework where partnerships and S corporations generally cannot be applicable entities and therefore cannot elect elective pay for the full list of applicable credits in the statute. Under this framework, however, partnership and S corporations, like any other filer, can still elect to be treated as an applicable entity with respect to an elective pay election for credits under sections 45Q, 45V, and 45X.

[53] Prop. Treas. Reg. § 1.6417-2(a)(1)(iii).

[54] More specifically, the Proposed Elective Pay Regulations provide that "the applicable entity's undivided ownership share of the applicable credit property will be treated as a separate applicable credit property owned by such applicable entity," meaning the applicable entity can claim elective pay with respect to that property. Prop. Treas. Reg. § 1.6417-2(a)(1)(iii).

[55] Prop. Treas. Reg. § 1.6417-2(b)(i).

[56] Prop. Treas. Reg. § 1.6417-2(b)(ii).

[57] *Id.*

if they were located in the US (specifically in the case of entities located in the territories), or, if they would not normally file an annual tax return at all, Form 990-T.[58]

The proposed regulations also establish a pre-filing registration process, whereby entities seeking elective pay must register each applicable credit property with the IRS as a condition of making an elective pay election.[59] The IRS will issue a registration number for applicable credit property, which entities must include on their Form 3800.[60] As part of that filing, entities will provide the IRS with certain information about the entity, the applicable credits it intends to claim, and the applicable credit property giving rise to those credits.[61] The registration number is only valid for the taxable year in which it is received, and to the extent an entity does not claim elective pay with respect to registered credit property in that taxable year, the entity will need to file again in the future to do so.[62]

#### 3.3.1.3 Determining the Elective Pay Amount

Section 6417(e) denies any double benefit to applicable entities that might arise as a result of making an elective pay election by reducing the applicable credit amount to zero in the year in which the election is made. Section 6417(h) provides that Treasury must issue regulations to ensure that the elective pay amount is "commensurate with the amount of the credit that would be otherwise allowable (determined without regard to section 38(c))." Pursuant to these sections, the proposed regulations set forth detailed steps to assist applicable entities in determining the elective pay amount and the amount of applicable credit available after making an elective pay election. Effectively, entities must first determine the amount of general business credits (including carryforwards and applicable credits) otherwise allowed against their federal tax liability under section 38(c); then, to the extent there are any unused applicable credits, entities may receive elective payment for the unused amount, and the remaining applicable credit amount for the current year is reduced to zero.[63]

#### 3.3.1.4 Application of Existing Statutory Provisions

Consistent with the statute, the proposed regulations turn off the limitations set forth in section 50(b)(3) and 50(b)(4)(A)(i), allowing tax-exempt organizations and governmental entities to claim ITCs (and elective pay on those credits) arising from the use of applicable credit property.[64] However, as mentioned above, the proposed regulations leave in place the limitation in section 50(b)(1), which precludes entities from claiming ITCs on credit property

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[58] *See* Prop. Treas. Reg. § 1.6417-1(b).

[59] *See* Prop. Treas. Reg. § 1.6417-5.

[60] Prop. Treas. Reg. § 1.6417-2(b)(2).

[61] *See* Prop. Treas. Reg. § 1.6417-5(b)(5).

[62] Prop. Treas. Reg. § 1.6417-5(c)(2).

[63] Prop. Treas. Reg. § 1.6417-1(h).

[64] Prop. Treas. Reg. § 1.6417-2(c)(1).

predominantly used outside the US.[65] The practical effect of this limitation is that applicable entities in the territories cannot make an elective pay election on ITCs arising from credit property used in the territories unless the property is owned by a domestic corporation.

The proposed regulations also apply the limitations set forth in sections 49 (providing the at-risk limitations for individuals or certain C corporations seeking investment tax credits) and 469 (providing the passive activity rules applicable to individuals, estates and trusts, closely held C corporations, and personal service corporations) by treating applicable credit property as used in the trade or business of the applicable entity making the elective pay election.[66]

In addition, the proposed regulations address the impact of existing rules related to acquiring investment credit property with income from grants, forgivable loans, and other tax-exempt amounts on the tax basis of credit property held by tax-exempt and governmental entities. Prop. Treas. Reg. § 1.6417-2(c)(3) provides that for credit property described under sections 30C, 45W, 48, 48C, and 48E, governmental and tax-exempt entities may generally include any tax-exempt amounts used to purchase or construct such property in the basis of that property for purposes of determining the credit. However, to the extent the tax-exempt amount is received specifically for constructing or purchasing credit property, and the tax-exempt amount plus the applicable credit exceeds the cost of the property, the proposed regulations reduce the applicable credit so that the excess amount equals zero.

### 3.3.1.5 Elective Payment for Credits Transferred under Section 6418

In response to public comment, the Proposed Elective Pay Regulations address whether applicable entities may claim elective pay for credits either purchased under section 6418(a) or otherwise obtained under another section of the Code, such as 45Q(f)(3)(B).[67] The preamble explains that while the statute does not specifically preclude such activity, sections 6417 and 6418 "are best interpreted to not allow an applicable entity under section 6417 to make an elective payment election for a transferred credit under section 6418" due to certain "administrative and practical reasons," which we discuss in more detail later in this comment.[68] This is generally consistent with Treasury's decision to exclude partnerships and S corporations from the definition of "applicable entity": both stem from Treasury's interpretation of the language in 6417(a), which states that an applicable entity may make an elective pay election with respect to any applicable credit "determined with respect to such entity."[69] Prop. Treas. Reg. §1.6417-2(c)(4) states that the phrase "determined with respect to such entity" means "the

[65] *See* Section 6417 Elective Payment of Applicable Credits, REG–101607–23, 88 Fed. Reg. 40528, 40531 (June 21, 2023).

[66] Prop. Treas. Reg. § 1.6417-2(c)(2).

[67] This provision allows filers eligible to claim the section 45Q credit to make an election to allow the person that disposes, utilizes, or uses the captured carbon oxide as tertiary injectant to claim the credit instead.

[68] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40538.

[69] *Id.* at 40534-38.

applicable entity or electing filer owns the underlying eligible credit property or, if ownership is not required, otherwise conducts the activities giving rise to the underlying eligible credit." This interpretation precludes applicable entities from purchasing credits under section 6418 and claiming elective pay on those credits.

### 3.3.2 Proposed Transferability Regulations

Like the Proposed Elective Pay Regulations, the Proposed Transferability Regulations address many of the issues raised in Notice 2022-50 and the public comments on the Notice. Among numerous other topics, the proposed regulations address how transferors may portion eligible credits and how bonus credits are stacked with base credits; explain in detail how transferors, including partnership and consolidated groups, may elect to transfer credits and the timing of doing so; describe the tax treatment, including timing and recognition, of payments for credits for transferors and transferees; address the application of section 469 to transferees; and clarify whether the transferor or transferee is responsible for recapture. Below, we discuss the proposed regulations briefly, focusing in part on the topics that are the subject of this comment while also providing general information about how the rules operate.

#### 3.3.2.1 Portioning and Stacking Credits

The proposed regulations permit transfers of a "specified credit portion" of an eligible credit, which reflects both a specified portion of the base credit and a proportionate share of each bonus credit associated and determined with respect to the base credit.[70] The proposed regulations make clear that transferors may not transfer any bonus credits separately from the base credit.[71] For example, transferors may not transfer a domestic content bonus credit without simultaneously transferring the related base credit.

#### 3.3.2.2 Manner of Making the Election

The preamble to the Proposed Transferability Regulations provide that, for the majority of the transfer-eligible credits, filers must register and make an election for transferability on a facility-by-facility basis;[72] transfers of credits under sections 30C, 48, and 48C are the exception, and the election for those credits must generally be made on a property-by-property basis.[73] For disregarded entities, the owner of the entity makes the election; for consolidated groups, members make the election; for partnerships and S corporations, the election is made by the partnership or S corporation; and for undivided ownership interests, each co-owner will make the election.[74] The proposed regulations clarify that partnerships or S corporations may qualify both

[70] *See* Prop. Treas. Reg. § 1.6418-1(h); Prop. Treas. Reg. § 1.6418-2(a)(2).

[71] *See* Prop. Treas. Reg. § 1.6418-1(h).

[72] Section 6418 Transfer of Certain Credits, REG–101610–23, 88 Fed. Reg. 40496, 40498 (June 21, 2023).

[73] *Id.*

[74] Prop. Treas. Reg. §1.6418-2(a)(3)(i)-(iv).

as a transferor or a transferee filer "assuming all other relevant requirements in section 6418 are met."[75]

Transfers of credits must be made for cash consideration,[76] and the election must be made during each taxable year in which the credit is transferred.[77] Moreover, the proposed regulations specify that the election is only permitted when the eligible credit is "determined with respect to an eligible taxpayer," meaning the transferor must own the underlying credit property or otherwise conduct the activities giving rise to the eligible credit.[78] The election to transfer a credit is irrevocable, and the election must be made on an original return, not a revised or amended return.[79]

#### 3.3.2.3 Registration Requirements

Similar to the registration process for elective payment, the proposed regulations establish a pre-filing registration process to prevent fraud and abuse in the transferability markets that will be in place before the end of 2023. Eligible filers must pre-file electronically with the IRS, providing information about eligible credit properties, "including their address and coordinates (longitude and latitude), supporting documentation, beginning of construction date, and placed in service date . . . ."[80] Eligible filers that satisfy the pre-filing registration requirements will then receive a registration number for each eligible credit property, which must be included on their return.[81]

#### 3.3.2.4 Tax Treatment

Consistent with the statute, the proposed regulations provide that the consideration paid by the transferee is not deductible by the transferee and is not included in the gross income of the transferor.[82] The proposed regulations specifically do not address the tax consequences of transaction costs or whether the transferee can deduct losses where the value of the amount paid exceeds the value of the credit.[83] Prop. Treas. Reg. § 1.6418-2(f) clarifies that where the taxable years of the transferor and transferee are different, the transferee must account for the credit in

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[75] Section 6418 Transfer of Certain Credits, 88 Fed. Reg. at 40504. For the proposed rule stating that partnerships and S Corporations may qualify as a transferor or a transferee, *see* Prop. Treas. Reg. § 1.6418-3(a)(1).

[76] *See* Prop. Treas. Reg. § 1.6418-2(a)(4)(ii); Prop. Treas. Reg. § 1.6418-2(e)(1).

[77] *See* Prop. Treas. Reg. § 1.6418-2(b)(4).

[78] Prop. Treas. Reg. § 1.6418-2(d)(1).

[79] Prop. Treas. Reg. § 1.6418-2(b)(4).

[80] Prop. Treas. Reg. § 1.6418-4(b)(5).

[81] Prop. Treas. Reg. § 1.6418-4(c)(5)(i).

[82] *See* Prop. Treas. Reg. § 1.6418-2(e)(3) (providing the payment is not deductible) and Prop. Treas. Reg. § 1.6418-2(e)(2) (providing the payment is not includible in gross income).

[83] Section 6418 Transfer of Certain Credits, 88 Fed. Reg. at 40502.

the "transferee taxpayer's first taxable year that ends after the taxable year of the eligible taxpayer."

### 3.3.2.5 Application of Passive Activity Rules to Transferees

The preamble to the proposed regulations provide that the credit utilization rules generally apply to transferee filers.[84] The proposed regulations further provide that for transferees that are otherwise subject to the passive activity limitations in section 469, the transferred credit will be "treated as earned in connection with the conduct of a trade or business," while at the same time, the transferee will not, as a result of a transfer election, be "considered to have owned an interest in the eligible taxpayer's business at the time the work was done (as required for material participation in §1.469-5(f)(1)) and cannot change the characterization of the transferee taxpayer's participation with respect to generation of the [transferred credit] by using any of the grouping rules in §1.469-4(c)."[85]

In effect, this rule prevents individuals, closely held C corporations, and personal service corporations from meeting the material participation requirement of the passive activity rules, meaning those entities can only claim the credits that they purchase against their passive tax liability. The preamble further explains that this is "consistent with the result that the transferee taxpayer does not apply rules that relate to the determination of an eligible credit because the transferee does not own the underlying eligible credit property to which the credit is determined or conduct the activity directly."[86]

### 3.3.2.6 Recapture

The proposed regulations generally place the risk of recapture of transferred credits on the transferee, providing that "[t]he transferee taxpayer is responsible for any amount of tax increase under section 50(a) upon the occurrence of a recapture event."[87] According to the preamble, this "is consistent with the statutory framework for recapture tax under section 50, which generally imposes recapture tax on the taxpayer who claimed the credit, regardless of whether such taxpayer owns the underlying property to which the credit is determined."[88] The preamble further provides that "there is no prohibition under section 6418 for an eligible taxpayer and a transferee taxpayer to contract between themselves for indemnification of the transferee taxpayer in the event of a recapture event."[89]

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[84] *Id.* at 40503; *see also* Prop. Treas. Reg. § 1.6418-2(f)(3)(ii).

[85] Prop. Treas. Reg. § 1.6418-2(f)(3)(ii).

[86] Section 6418 Transfer of Certain Credits, 88 Fed. Reg. at 40503.

[87] Prop. Treas. Reg. § 1.6418-5(d)(3)(i).

[88] Section 6418 Transfer of Certain Credits, 88 Fed. Reg. at 40508.

[89] *Id.* at 40509.

## 4 Comments on Elective Payment

### 4.1 Improve Access to Investment Tax Credits for Applicable Entities in Territories

The Proposed Elective Pay Regulations clarify that the government of any US territory, or a political subdivision thereof, is an applicable entity for purposes of section 6417 or provisions of law referencing section 6417(d)(1)(A). This is an appropriate clarification well-grounded in statute and an important step towards ensuring that territory governments—including their political subdivisions, agencies, and instrumentalities—are treated similarly to governmental entities within the 50 States and the District of Columbia. This is also a sound clarification in light of the statutory context of the IRA monetization principles that sheds light on the access challenges that they are intended to address, as laid out in Part 3.1 above. Ensuring full access for IRA credits for projects located in the territories is squarely within the set of access challenges that lawmakers have historically sought to address using various monetization mechanisms, given the unique status of territories and the specific energy security challenges faced by their residents, businesses, and governments.

However, the Proposed Elective Pay Regulations stop short of providing full access and parity and would leave projects in the territories with less access to IRA tax credits compared to projects in the States. This is because the Proposed Elective Pay Regulations take a reasonable—but not compelled—interpretation of pre-existing law and how it interacts with the IRA. That interpretation precludes territory governments and other entities using credit property in the territories from seeking an elective payment for ITCs under sections 48 and 48E, the clean vehicle and charging credits under sections 45W and 30C, and the advanced manufacturing credit under section 48C. This, in turn, inhibits the ability of territory governments, tax-exempt organizations, and businesses to invest in key technologies needed to build out grid resiliency and distributed generation, such as energy storage and microgrids. It also means that territory governments are precluded from applying for the low-income communities bonus credit. This is because section 50(b)(1)—enacted under prior law—limits the availability of ITCs with respect to property used outside the US.[90] This provision creates tension in the statutory scheme, as section 6417 states that an applicable entity (which the Proposed Elective Pay Regulations clarify includes a territory government) making an election with respect to *any* of the applicable credits will be treated as making a payment against the tax imposed by subtitle A.[91]

Just as Treasury clarified that the definition of applicable entity includes territory governments in the Proposed Elective Pay Regulations, we recommend that Treasury exercise its authority under section 6417(h) to issue a rule clarifying that territory governments and other applicable entities are eligible for elective pay for all applicable credit property used in the territories. In addition to furthering the purposes of the IRA, this change would be consistent with the approach Treasury has taken in other IRA implementation contexts.[92] Our comments focus on whether credits can

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[90] Section 50(b)(1).

[91] Section 6417(a).

[92] One example involves the intersection of the Corporate Alternative Minimum Tax and transferability under section 6418. Under section 56A, Adjusted Financial Statement Income ("AFSI") shall, in general, "be appropriately

be determined with respect to property predominantly used in the territories based on considerations related to the structure and purposes of the IRA and its monetization provisions that are unique to the territories. Our suggestions would not alter the rules regarding the classes of filers eligible for credits, such as under Code section 50(b)(4)(A)(ii).

#### 4.1.1 The Existing Statutory and Regulatory Framework Prevents Access to Certain IRA Credits in the Territories

Section 50(b) provides that certain property is not eligible for some of the ITCs. A key set of restrictions relevant for projects located in the territories are contained in sections 50(b)(1), (3), and (4)(A). Sections 50(b)(3) and 50(b)(4)(A)(i) generally prohibit tax-exempt entities and governmental units respectively from accessing the ITCs in sections 46 though 48E. Section 50(b)(3) provides, in part, that:

> No credit shall be determined under this subpart with respect to any property used by an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter unless such property is used predominantly in an unrelated trade or business the income of which is subject to tax under section 511.

Similarly, under section 50(b)(4)(A)(i), "[n]o credit shall be determined under this subpart with respect to any property used by the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing . . . ." Under these provisions, prior to the IRA, a territory government, or a tax-exempt entity operating therein, was generally prohibited from earning ITCs. However, the IRA expands access to credits to tax-exempt and governmental entities. In order to achieve that goal, section 6417 turns off the rules described above when an elective pay election is made.[93] This special rule further provides that, in the case of an applicable entity making an elective pay election, the credit is determined "by treating any property with respect to which such credit is determined as used in a trade or business of the applicable entity."[94] This is a crucial rule. Elective pay is intended to allow tax-exempt and governmental entities to benefit from these tax credits; it would defeat this purpose to apply the section 50(b) limitations to entities seeking elective payment.

The special rule turning off sections 50(b)(3) and (4)(A)(i) when an elective pay election is made is silent on the application of section 50(b)(1). Section 50(b)(1) provides that, in general, "no credit shall be determined under this subpart with respect to any property which is used predominantly outside the United States." For purposes of the Code, "[t]he term 'United States'

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adjusted to disregard any amount treated as a payment against the tax imposed by subtitle A pursuant to an election under section 48D(d) or 6417." Section 56A(c)(9). The statute is silent on adjusting AFSI when an election is made under 6418. Despite the statutory silence on the treatment of consideration of amounts received for credits transferred under section 6418, Treasury has determined that it is generally appropriate to disregard these amounts in determining AFSI. *See* Notice 2023-7, 2023-3 I.R.B. 390, section 6.02(2).

[93] *See* section 6417(d)(2)(A) ("In the case of any applicable entity which makes the election described in subsection (a), any applicable credit shall be determined . . . without regard to paragraphs (3) and (4)(A)(i) of section 50(b) . . .").

[94] Section 6417(d)(2)(B).

when used in a geographical sense includes only the States and the District of Columbia."[95] In other words, for purposes of section 50(b)(1), the territories are not considered to be part of the US, and so the general rule in section 50(b)(1) would prohibit earning covered credits for property predominantly used in the territories. There is an exception in section 50(b) that turns off this rule for "any property described in section 168(g)(4)." Most relevant for IRA credits for property predominantly used in the territories is section 168(g)(4)(G), which covers:

> any property which is owned by a domestic corporation or by a United States citizen (other than a citizen entitled to the benefits of section 931 or 933) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States.

Thus, for US citizens who are not residents of the territories and for US corporations, but not for other persons, property used in the territories can generally qualify for ITCs.

The Proposed Elective Pay Regulations do not turn off section 50(b)(1) when an election under section 6417 is made.[96] Section 50(b)(1) applies directly to ITCs in sections 46 through 50. Other tax credit provisions incorporate similar rules (or a portion of them) through cross-reference.[97] Therefore, as described by the IRS, "property used in the territories and owned by a territory government, or an entity created in or organized under the laws of a U.S. territory generally would not qualify for the section 30C, 45W, 48, 48C, and 48E credits."[98] The consequence is a complex, confusing, and seemingly-arbitrary system for determining whether projects in territories are eligible for certain credits, as partially illustrated in the following chart:

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[95] Section 7701(a)(9).

[96] *See* section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40531 ("Several stakeholders requested clarification that tax-exempt entities in the U.S. territories are eligible to make an election under section 6417. Under these proposed regulations, such entities would be considered organizations exempt from the tax imposed by subtitle A as long as they are exempt from taxation by section 501(a) and as long as they meet the requirements to claim an applicable credit (such as being an appropriate owner of an investment credit property under sections 50(b)(1)(B) and 168(g)(4)(G)).").

[97] *See*, *e.g.*, sections 30C(e)(2)-(3) and 30D(f)(4).

[98] IRS, Elective Pay and Transferability Frequently Asked Questions: Elective Pay (last visited August 3, 2023) ("Elective Pay and Transferability FAQs"). Sections 45W (credit for qualified commercial clean vehicles), 48 (energy credit), 48C (qualifying advanced energy project credit), and 45E (clean electricity investment credit) are directly subject to section 50(b) rules, due to their housing in subpart E of Part IV of subchapter A of Chapter 1 of the Code. Section 30C(e)(3) provides that "[n]o credit shall be allowable under subsection (a) with respect to any property referred to in section 50(b)(1) or with respect to the portion of the cost of any property taken into account under section 179." Section 45W(d)(1) incorporates similar rules to section 30D(f) (without regard to paragraph (10) or (11) thereof), and section 30D(f)(4) provides that "[n]o credit shall be allowable under subsection (a) with respect to any property referred to in section 50(b)(1)."

| | Applicable Entities in Territories | Applicable Entities in States |
|---|---|---|
| Clean Energy ITCs (inc. storage; microgrids; and the low-income communities bonus program) | **No credit** | Elective pay |
| Clean Energy PTCs | Elective pay | Elective pay |
| Clean nuclear PTC | Elective pay | Elective pay |
| CCS | Elective pay | Elective pay |
| Clean Fuel PTC | Elective pay | Elective pay |
| Clean Hydrogen PTC | Elective pay | Elective pay |
| Commercial Clean Vehicles | **No credit** | Elective pay |
| Clean Vehicle Refueling Property | **No credit** | Elective pay |
| Advanced Energy ITC | **No credit** | Elective pay |
| Advanced Mfg PTC | Elective pay | Elective pay |

This demonstrates that the current rules, including those in the Proposed Elective Pay Regulations, would leave projects in the territories without access to important credits available to governmental entities in the States. Some projects in the territories that would ideally receive ITCs could still receive PTCs. However, PTCs do not cover all technologies subsidized by IRA tax credits. For example, energy storage technology and microgrid controllers are eligible for the ITC under section 48, but not under section 45. These technologies can be particularly useful for energy security projects, which are especially important for, and increasingly used in, the territories.[99] In addition, PTCs do not cover clean vehicle technologies (either the credit for commercial clean vehicles under section 45W, or the credit for clean vehicle recharging property under section 30C). Furthermore, the allocated credit under section 48(e) is only available for ITC projects. Without a change in the final regulations, certain potential territory projects will be ineligible for these credits.

#### 4.1.2 Improving Access to Credits in the Territories Is Within Treasury's Authority and Uniquely Furthers the Goals of the IRA

The final regulations can ensure better tax credit access for projects in the territories by permitting credits to be calculated without regard to section 50(b)(1)(A) for property that will be used predominantly in the territories. This rule would be consistent with the statute and within the Secretary's broad regulatory authority. It would be consistent with the structure within sections 6417 and 6418. And it would further the Administration's goals.

As described above, section 6417 does not explicitly provide exceptions to section 50(b)(1) for property predominantly used in the territories. However, the IRA gives broad discretion to the Secretary to do so. First, section 6417(h) provides that "[t]he Secretary shall issue such regulations or other guidance as may be necessary **to carry out the purposes of this section.**"[100]

[99] *See* Javier Rúa Jovet & Tierney Sheehan, *Hurricane-Proof Energy for Puerto Rico*, RMI (October 27, 2022).

[100] Section 6417(h) (emphasis added).

Second, this broad authority is bolstered by grants of regulatory authority contained in key credit provisions that are subject to section 50(b)(1). The broadest grants of authority are in sections 45W and 48, which instruct the Secretary to issue "guidance as the Secretary determines necessary **to carry out the purposes of this section**."[101] The next broadest authority is found in section 30C(h), which instructs the Secretary to "prescribe such regulations as necessary to carry out the provisions of this section." This level of authority offers similar discretion to that found in section 48E(i), instructing the Secretary to "issue guidance regarding implementation of this section" (although section 48E(i) also includes a deadline). Section 48C is a capped, allocated tax credit, and instructs that "the Secretary, in consultation with the Secretary of Energy, shall establish a qualifying advanced energy project program to consider and award certifications for qualified investments eligible for credits under" section 48C. The basic structure of a capped allocated tax credit necessitates broad discretion by the Secretary (or, in this case, the Secretaries). Section 6417(h) provides sufficient authority to turn off section 50(b)(1) for property predominantly used in the territories when an elective pay election is made, and that authority is bolstered by grants of regulatory authority in the sections that provide that the IRA credits are subject to section 50(b).

The structure of the elective pay regime also supports turning off section 50(b)(1) for property predominantly used in the territories when an elective pay election is made. Section 6417 broadens access to clean technology tax credits to governmental entities, tax-exempts, rural electric cooperatives, and public power—entities that have historically been locked out of these credits. Section 6417 explicitly permits these applicable entities to access ITCs through the elective payment regime. As noted above, section 6417 turns off paragraphs (3) and (4)(A)(i) of section 50(b). This change ensures that governmental entities and other applicable entities get full access to applicable credits for projects in the States. However, as shown above, the failure to explicitly turn off section 50(b)(1) leaves uncertainty and complexity in the territories. The recommended relief would relieve administrative burden for filers in the territories, as they would not need to form a new corporation in the States in order to own and access ITCs. It would also encourage the use of section 6417 and 6418 elections, which offers the IRS more up-front information through pre-filing, allowing the IRS to better monitor compliance and target enforcement activity. There is nothing in the structure of the credits or section 6417 suggesting that access to credits for projects in the territories should be far more generous for PTCs than for ITCs.

[101] Sections 45W(f) and 48(a)(15)(E) (emphasis added). The housing of the regulatory grant in section 48 is somewhat confusing. Typically, broad regulatory grants covering an entire Code section are placed at or near the end of the section. Here, the grant is place within section 48(a)(15), which relates to the election to treat clean hydrogen facilities as energy property. Congressional intent was likely to have the regulatory grant in section 45(a)(15)(E) only to this election. However, it would be unusual for legislative counsel to confuse a "section" with a "paragraph." And, in any event, the impact would be minimal, since similarly broad regulatory authority is contained in section 48(a)(16). This provision instructs the Secretary to issue "guidance as the Secretary determines necessary to carry out the purposes of" subsection (a). Subsection (a) is the heart of the section 48 credit, and so the Secretary clearly has broad latitude to issue regulations carrying out the purposes of section 48.

Ensuring access to the full suite of IRA credits for projects located predominantly in the territories when an elective pay election is made would further the purpose of these provisions and the access challenges that they are intended to address, as shown by the context of incremental—and now robust—changes to monetization mechanisms for energy tax provisions in the Code over time (see Part 3.1.1). As the Assistant Secretary for Tax Policy has noted:

> Direct pay and transferability are central to achieving our economic and climate goals. They will act as a force multiplier for companies and enable communities, startups, and nonprofits to access the credits. Projects will get built more quickly and affordably to reduce costs for families and businesses, and more communities will benefit.[102]

The White House, pointing to the "converging economic, health, and climate crises that have exposed and exacerbated inequities" directs agencies to "pursue a comprehensive approach to advancing equity for all, including people of color and others who have been historically underserved, marginalized, and adversely affected by persistent poverty and inequality."[103] In a subsequent memorandum—the first recipient being the Secretary of the Treasury—agencies are instructed to "[i]mprove climate resilience to reduce vulnerability to natural disasters and ensure that underserved communities benefit from and participate in the clean energy economy, consistent with the administration's Justice 40 initiative."[104]

Treasury has taken some important steps forward in realizing these goals in the implementation of the climate tax provisions, including by clarifying that territory governments are eligible for elective pay. In addition, Treasury has prioritized implementation of the low-income communities bonus credit program. Final regulations on this program were recently issued, and Deputy Secretary Adeyemo outlined three goals of this program:

1. Increase the adoption of and access to renewable energy facilities in low-income communities and other communities with environmental justice concerns;
2. Encourage new market participants in the clean energy economy; and

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[102] *See* U.S. Dep't of Treasury, Remarks by Assistant Secretary Batchelder, *supra* note 7.

[103] Executive Order No. 13985, Advancing Racial Equity and Support for Underserved Communities Through the Federal Government, 86 Fed. Reg. 7009, 7009 (January 25, 2021); *see also* Press Release, U.S. Dep't of Treasury, IRS Releases Final Rules and Guidance on Investing in American Program to Spur Clean Energy Investments in Underserved Communities (August 10, 2023) ("IRS Final Rules on Investing in America Program") ("'One of the goals of Bidenomics is to ensure all Americans benefit from the growth of the clean energy economy,' said Deputy Secretary of the Treasury Wally Adeyemo.").

[104] Domestic Policy Council, *Guidance for Federal Departments and Agencies on Advancing Equitable Community and Economic Development in American Cities and Urban Communities* (May 26, 2023). This memorandum applies to various federal programs, including "tax incentives related to housing, community facilities and amenities, transportation, climate adaptation and resilience."

3. Provide social and economic benefits to people and communities that have been historically overburdened with pollution, adverse health or environmental effects, and marginalized from economic opportunities.[105]

But unless our recommendation in this Part is adopted, territory residents will be functionally left out of the low-income communities bonus credit program. This is directly in conflict with the goals of the IRA, and of this program, as correctly understood and articulated by the Administration.

There are several reasons why it would be especially appropriate for Treasury to adopt our recommendation in this Part in light of the purposes of the IRA and its monetization provisions.

First, the emissions reduction, equity, and energy security aims of the IRA are especially pressing in the territories. Territory residents have been uniquely and disproportionately burdened by the effects of climate change, have been disproportionately impacted by natural disasters,[106] have low energy security, experience higher rates of poverty than any State, and have often been denied access to critical federal programs.

Second, the territories also have a unique relationship with the US reflected in many legal arrangements and frameworks. This has been specifically and appropriately recognized in this Administration's approach to a range of administrative issues.[107]

Third, policymakers have taken steps in recent years to make territory residents eligible for certain federal tax credits.[108] Because of these and other unique tax treatments relating to territories, the tax system and tax administration has established relationships with territory filers and tax administrators.[109] The IRS's recent steps to expand services in certain territories in ways intended to improve access and compliance flow from this unique tax administration relationship.[110]

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[105] U.S. Dep't of Treasury, *The Low-Income Communities Bonus Credit Program: Our Approach to an Inclusive Clean Energy Economy* (August 10, 2023). If this comment is adopted, then further conforming change will be needed to the final regulations implementing the section 48(e) low-income communities bonus credit. While the proposed regulations included territories in the definition of "qualified tax-exempt entity," territories were removed from that definition in the final regulations. Additional Guidance on Low-Income Communities Bonus Credit Program, T.D. 9979, 61-62 (August 10, 2023).

[106] Executive Order 14091 establishes that "persons who live in United States Territories" are "underserved communities" for purposes of key equity initiatives. *See* Executive Order No. 14091, Further Advancing Racial Equity and Support for Underserved Communities Through the Federal Government, 88 Fed. Reg. 10825, 10832 (February 22, 2023).

[107] *See, e.g.,* Executive Order No. 14008, Tackling the Climate Crisis at Home and Abroad, 86 Fed. Reg. 7619, 7620 (February 1, 2021).

[108] *See, e.g.,* American Rescue Plan Act of 2021, Pub. L. No. 117-2, § 9612, 135 Stat. 4, 150-52 (2021).

[109] IRS News Release IR-2004-1306 (November 10, 2004).

[110] IRS A Closer Look CL-22-08 (May 11, 2022); IRS News Release PR-2023-01 (January 24, 2023).

The policy rationale for applying the section 50(b)(1) rules to applicable entities for property that will be used in the territories, especially in light of this context of the monetization provisions, is unclear. Most likely, it was inadvertence not to turn off section 50(b)(1) for the territories in the same way that sections 50(b)(3) and (4)(A)(i) were turned off. As discussed above, it is well within Treasury's regulatory authority to remedy this.

Another possible rationale for applying the section 50(b)(1) rules is concerns about fraud. However, the approach in the Proposed Elective Pay Regulations is neither a statutorily compelled nor an administratively effective way of addressing fraud concerns. As noted above, section 50(b)(1) does not prevent claiming ITCs for projects predominantly used in the territories. Instead, it requires a domestic corporate partner. This may provide some fraud protection, as the IRS may have better ability to monitor and audit credits claimed by domestic corporations than by other filers. However, this form of theoretical fraud protection is obsolete in a post-IRA world. Sections 6417 and 6418 give Treasury express authority to "require such information or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments."[111] The Proposed Elective Pay and Transferability Regulations begin to build this process out. This pre-filing registration system is the better tool for managing fraud risk for projects in the territories and obviates the need for section 50(b)(1), at least for projects that make elections under sections 6417 and 6418 and thus must go through the pre-filing registration process.

As Part 3.1 of this comment lays out, in the structure and context of the IRA's monetization provisions, compliance concerns should be addressed by relying first and most heavily on these specific statutory tools provided to address compliance concerns: the novel preregistration regime, and the ability to leverage private transfer markets in ways that increase compliance. Denying access to monetization methods for certain market participants or projects, when that access is authorized by statute and consistent with the access goals of the legislation, should be the last resort for addressing compliance risks.

Further, as noted above, many IRA credits are available to territory governments and tax-exempts operating in the territories. Therefore, fraud risk for properties in the territories must be managed, even if appropriate exceptions to the section 50(b)(1) rules were not adopted. This means that the Administration should be deepening its administrative capacity to bolster compliance with respect to activities in the territories, as it has recently done in other areas involving the interaction between the federal tax code and activity in the territories.[112] It can choose to deploy some of the funding for IRA climate tax implementation and/or IRA funding for rebuilding the IRS compliance function to do so.

This recommendation is consistent with Treasury's appropriate use of regulatory authority contained in the IRA in other contexts, to ensure appropriate treatment of IRA tax credits, even

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[111] Sections 6417(d)(5) and 6418(g)(1).

[112] Press Release, U.S. Dep't of Treasury, Building on Filing Season 2023 Success, IRS Continues to Improve Service, Pursue High-Income Individuals Evading Taxes, Modernize Technology (July 14, 2023).

when the statute is silent. First, Treasury, in the Proposed Elective Pay Regulations, has already added US territories to the list of applicable entities, specifically as "organizations" exempt from tax, notwithstanding that territories are exempt from tax under section 115 (in a manner similar to States) rather than section 501 and other sections governing tax-exempt organizations. Another example involves the intersection of the Corporate Alternative Minimum Tax and transferability under section 6418. Under section 56A, AFSI shall, in general, "be appropriately adjusted to disregard any amount treated as a payment against the tax imposed by subtitle A pursuant to an election under section 48D(d) or 6417."[113] The statute is silent on adjusting AFSI when an election is made under 6418. Despite the statutory silence on the treatment of consideration of amounts received for credits transferred under section 6418, Treasury has determined that it is generally appropriate to disregard these amounts in determining AFSI.[114]

### 4.1.3 Proposed Regulatory Language

Based on the foregoing, we recommend that the final regulations provide an exception to section 50(b)(1) with respect to IRA tax credits related to property used predominantly in the territories, at least when an elective pay election is made.[115] As noted above, this proposal is within Treasury's authority, is consistent with the structure and purpose of the relevant provisions of the IRA, and is consistent with recent precedent in implementation of IRA provisions (including the monetization provision under section 6418).

*Proposed Regulatory Language*

This recommendation can be achieved by modifying Prop. Treas. Reg. § 1.6417-2(c)(1) to read as follows:

> (c) *Determination of applicable credit* —(1) *In general.* In the case of any applicable entity making an elective payment election, any applicable credit is determined—
>
> (i) Without regard to section 50(b)(3) and (4)(A)(i) of the Code,
>
> (ii) By treating any property with respect to which such credit is determined as used in a trade or business of the applicable entity, and
>
> (iii) In the case of property which is used predominantly in a U.S. territory, without regard to section 50(b)(1) of the Code.

Alternatively, if Treasury were to determine that turning off 50(b)(1) for all applicable entities using credit property in the territories is not appropriate, Treasury could consider a narrower

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[113] Section 56A(c)(9).

[114] *See* Notice 2023-7, 2023-3 IRB 390, section 6.02(2).

[115] Full adoption of this comment would require coordinating changes to guidance implementing sections 30C and 45W. *See* sections 30C(e)(3) and 45W(d)(1) (incorporating rules similar to section 30D(f)(4)).

approach and only permit territory governments to make an elective pay election. In that case, modified Prop. Treas. Reg. § 1.6417-2(c)(1)(iii) would read as follows:

> (iii) In the case of property which is used predominantly in a U.S. territory by a territory government, including any agency or instrumentality thereof, without regard to section 50(b)(1) of the Code.

Though this modification would not ensure full access to the credits in the territories, it would, at a minimum, ensure access for territory governments (which Treasury added to the list of applicable entities in the Proposed Elective Pay Regulations). This modification would also be consistent with Treasury's reason for adding territory governments to the list of applicable entities, which is that section 115 similarly excludes certain income accruing to States or political subdivisions thereof and income accruing to the governments of the territories.

### 4.2 Consider Allowing Section 6417 Elections for Credits Earned Through Similar Partnerships

Prop. Treas. Reg. § 1.6417-2(a)(1)(iv) provides that partnerships and S corporations are not applicable entities as described in section 6417(d)(1)(A) and Prop. Treas. Reg. § 1.6417-1(c), unless the partnership or S corporation is itself the electing filer under section 6417(a).

As described in the preamble to the Proposed Elective Pay Regulations, Treasury's interpretation of the phrase "determined with respect to such entity" in section 6417(a) would preclude the possibility of looking through to partners or shareholders to determine whether credits are eligible for elective pay. Treasury's stated rationale is that the "partnership or S corporation, not the partners or shareholders, makes the election" described in section 6417(c), and that the credit must be "held directly by the partnership or S corporation," meaning that the partnership or S corporation, not the partners or the shareholders, is the relevant entity for these purposes.[116] The preamble also discusses how elective pay elections are made for a particular applicable credit property, such that allowing an elective pay election for a portion of an applicable credit property would be contrary to section 6417(a) and, if permitted, would be difficult to administer.

However, the preamble to the Proposed Elective Pay Regulations provides that an applicable entity "may engage with other entities, including with for-profit partners, in a partnership arrangement that has properly elected out of subchapter K and make an elective payment election . . . determined with respect to its share of the underlying applicable credit property."[117] Prop. Treas. Reg. § 1.6417-2(a)(1)(iii) specifically provides that if an applicable entity is a co-owner of an applicable credit property through an ownership arrangement treated as a tenancy-in-common or pursuant to a joint operating arrangement that has properly elected out of subchapter K under section 761, the applicable entity may then make an elective payment election under section 6417(a). Each owner is considered to own an undivided interest in or share of the underlying

[116] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40534.

[117] *Id.*

applicable credit property. Treasury requested comments as to whether additional rules were needed.

### 4.2.1 Problems with Tenancy-in-Common and Election out of Subchapter K

While it is true that tenancies-in-common or joint operating arrangements that elect out of subchapter K treatment can in theory offer alternatives to partnerships, there is a significant risk that applicable entities may unknowingly enter into joint operating arrangements that constitute partnerships for tax purposes. This may be especially true for local governments, who may not have expertise in tax or partnership law.

Indeed, even for applicable entities with tax expertise, the existing guidance related to tenancies-in-common is limited to the point where Treasury should strongly consider issuing safe harbor guidance to ensure tenancy-in-common arrangements are respected. Partnership is defined in the Code in the regulations under sections 761 and 7701, but the line between a tax partnership and a tenancy-in-common that will be respected as such for tax purposes is not well-defined. Pre-IRA partnership guidance is widely used as a basis for structuring projects within the renewable industry, and acceptable tax equity structures are well-understood,[118] but existing guidance for tenancy-in-common generally is quite limited and the most relevant guidance specific to tenancy-in-common discussing energy generation is over fifty years old.

The most recent guidance distinguishing tenancy-in-common from partnerships is Rev. Proc. 2002-22, which addresses fractional interests in rental real property. It notes at the outset that "partnership for federal tax purposes is broader in scope than the common law meaning of partnership and may include groups not classified by state law as partnerships."[119] It goes on to describe the definition of a tenancy-in-common, where each owner is deemed to individually own a physically undivided part of the property, receive a proportionate share of the rents, to demand a partition of the property, to transfer the interest, and generally exercise the benefits of ownership as long as they do not detract from other tenants-in-commons' ownership of the property. The revenue procedure identifies certain characteristics that would indicate such arrangements should be treated as partnerships, including limitations on the ability to sell or lease either the underlying property or stake, and the managers' effective participation in profits and losses. Finally, the revenue procedure states that "[w]here the parties to a venture join together capital or services with the intent of conducting a business or enterprise and of sharing the profits and losses from the venture, a partnership (or other business entity) is created."[120]

The most detailed guidance discussing tenancies-in-common in an energy production context is Revenue Ruling 68-344.[121] It describes an arrangement where several power corporations

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[118] *See* Rev. Proc 2007-65, 2007-2 C.B. 967; Rev. Proc. 2020-12, 2020-11 I.R.B. 511. *See also* Martin, *supra* note 9.

[119] Rev. Proc. 2002-22, 2002-1 C.B. 733 (citing *Bergford v. Commissioner*, 12 F.3d 166, 169 (9th Cir. 1993)).

[120] Rev. Proc. 2002-22 (citing *Bussing v. Commissioner*, 88 T.C. 449, 460 (1987), *aff'd on reh'g*, 89 T.C. 1050 (1987)).

[121] Rev. Rul. 68-344, 1968-1 C.B. 569; *see also* Rev. Rul. 82-61, 1982-1 C.B. 13.

operated a power-generating unit under tenancy-in-common and operating agreements, with each corporation providing for transmission of its own share of power sold separately to different customers on their own accounts. The IRS concluded that the venture was a partnership for income tax purposes, but stated that such arrangements were eligible to elect out of subchapter K treatment under former Treas. Reg. § 1.761-1(a)(2)(iii), requiring, in relevant part, that the co-owners reserve the right to separately to take in kind or dispose of their shares of any property produced, extracted, or used.[122] Since the participants in the venture "not only reserve the right to take distribution in kind and dispose of the product produced, but they actually take the product from the central generators and divert it into their own systems," they were able to elect out of subchapter K treatment.[123]

The two above pieces of guidance demonstrate both the unclear nature of the line between tenancy-in-common and operating arrangements that may elect out of subchapter K on the one hand, and tax partnerships on the other hand, as well as the lack of guidance applicable to the modern clean energy industry in particular. Additional guidance is especially necessary because the applicable entities likely to invest in renewable projects are also likely to be reluctant to participate in funding projects unless risk is minimized.

The need for guidance in the event that applicable entity co-venturers in clean energy projects must use tenancies-in-common rather than partnerships in order to receive elective pay will also require the IRS to devote substantial future resources to reduce tax uncertainty. The stakes of a tax recharacterization of a tenancy-in-common as a tax partnership are very high. An applicable entity that claimed elective pay in a situation where elective pay was not allowed will have made an ineffective claim, resulting in an obligation to repay the elective payment to the federal government, along with interest and possibly penalties. At a minimum, applicable entities will want published guidance, so they can structure their tenancies-in-common with the confidence that they will not be recharacterized. For many applicable entities this may not be sufficient; they may wish to obtain private letter rulings for additional assurance. Providing this assurance, whether through published guidance or private letter rulings, will impose a significant resource burden on the IRS.

Limiting the pool of applicable entities to the few entities that might be willing to invest through tenancies-in-common or those that have the required ability and expertise to stand up projects on their own will unnecessarily limit the deployment of these credits. A key purpose of elective pay is to allow new entrants, such as applicable entities, to invest in clean technologies and access tax credits for doing so. Applicable entities may fund projects that might not otherwise be profitable for other types of developers, or that would particularly benefit low-income or rural areas, but these entities may not have the capacity to separately meter or sell power output as described in Revenue Ruling 68-344. These entities should not be denied the ability to allocate risk, obtain

[122] Rev. Rul. 68-344, 1968-1 C.B. 569.

[123] *Id.*

expertise, or creatively finance projects with partners the way that for-profit entities are able to do through tax equity partnership structures.

Another consideration is the relative lack of advising expertise for tenancies-in-common as compared to partnership structures. Our understanding is that there is limited existing experience among tax advisors with tenancies-in-common, and that the limited and dated existing tenancy-in-common guidance also reflects the limited pre-IRA adviser expertise and interest in this space. The ability of advisers to get up to speed on tenancy-in-common practices, feel comfortable making recommendations to risk-averse clients, and receive clarifications or confirmations from regulators about tenancy-in-common arrangements may be a source of delay and transaction costs in deploying clean energy tax credits, as well as an administrative burden for the IRS, if the Proposed Elective Pay Regulations are finalized in their current form.

At a minimum, it would be very helpful if safe harbor guidance for tenancies-in-common were issued in a timely manner —even on an interim or temporary basis— to ensure that risk-averse entities can effectively support clean energy projects with the expectation that they will receive elective pay.

#### 4.2.2 Recommendations

In light of the challenges of the tenancy-in-common approach, we believe Treasury should re-visit the use of partnerships in the elective pay context. In this part, we set forth our recommendations on similar partnerships and set out the statutory basis and authority to adopt potential alternative approaches.

First, Treasury should clarify that operating agreements and other arrangements that consist solely of agencies or instrumentalities that are part of the same State or political subdivision within the meaning of section 6417(d)(1)(A)(ii), should be treated as applicable entities, regardless of whether they elect out of subchapter K treatment. Joint arrangements consisting of state agencies or instrumentalities from different States should likewise be treated as applicable entities regardless of whether they elect out of subchapter K. This would be consistent with the intent as described in the preamble to the Proposed Elective Pay Regulations, which notes the existence of such structures as special purpose entities including "joint action agencies, economic development corporations, and joint action authorities," and acknowledges that "different States may structure ownership of property differently."[124] This guidance would provide needed clarity to local governments, would align with the purposes of the statutory scheme of section 6417, and would simplify tax administration for the IRS when engaging with these entities, which pose a low risk of claiming credits fraudulently. Treasury should consider offering guidance clarifying the mechanics of pre-filing and making section 6417 elections under such arrangements, and whether the election is made on a single Form 990-T, or on multiple forms.

[124] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40533.

Second, Treasury should reconsider the treatment of partnerships that are wholly comprised of applicable entities ("similar" partnerships) before finalizing the Proposed Elective Pay Regulations. Treasury should treat similar partnerships as applicable entities under section 6417(d)(1)(A), making them eligible to receive elective pay on a partnership level. We believe that the statute provides sufficient authority for Treasury to look through partnerships to partners in order to determine the extent to which a credit can be accessed through elective pay and offer two alternative approaches to interpreting the language of 6417(a) and its relevance for determining applicable entities.

The first alternative approach would view partnerships as conceptually comprised of their partners—consistent with how partnerships are treated as pass-through entities elsewhere in the Code. This approach would interpret the "entity" referred to in 6417(a) as the individual partner. This approach is supported by approaches of prior partnership regulations under sections 702 and 50 that attribute tax credits to the partners and then compute the tax consequences of the credit at the partner level.

Section 702 generally addresses how partners account for distributive shares of partnership items. In particular, section 702(a)(7) provides that each partner must separately take into account "other items of income, gain, deduction, loss, or **credit**, to the extent provided by regulations . . ." (emphasis added). Treasury has historically interpreted this authority to require separate partner reporting of tax items broadly, as demonstrated by the text of Treas. Reg. 1.702-1(a)(8)(ii):

> Each partner must also take into account separately the partner's distributive share of any partnership item which, if separately taken into account by any partner, would result in an income tax liability for that partner, or for any other person, different from that which would result if that partner did not take the item into account separately.

In effect, the current section 702 regulations require separate partner-level reporting of a partnership item whenever such separate reporting would result in a different income tax liability for that partner or any other person. Once separate partner level reporting is required, section 702(b) provides that:

> The character of any item of income, gain, loss, deduction or credit included in a partner's distributive share under [section 702(a)(1) through (7)] shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

These sections, which codify the fundamental pass-through tax nature of partnerships, empower Treasury to issue regulations treating partners as realizing tax credits directly—especially since an elective pay obligation is technically an overpayment of tax requiring separate partner reporting under Treas. Reg. § 1.702-1(a)(8)(ii).

This view is reaffirmed by the preamble to the 2016 temporary regulations issued under section 50, addressing the income inclusion rules applicable to the lessee of investment credit property (and lessees of investment credit property that are partnerships), including energy credits under section 48 (also applicable credits for the purposes of section 6417).[125]

The preamble states:

> The Treasury Department and the IRS believe that, because the investment credit and any limitations on the credit itself are determined at the partner or S corporation shareholder level, it is appropriate that the income inclusion occurs at the partner or shareholder level. **In the case of a partnership that actually owns the investment credit property, a partner in a partnership is treated as the taxpayer with respect to the partner's share of the basis** of partnership investment credit property under § 1.46-3(f)(1) and separately computes the investment credit based on its share of the basis of the investment credit property. . . . **The credit is therefore computed at the partner level based on partner level limitations**.[126]

The statutory language in section 50 itself also reaffirms this view. Section 50(b)(3) and (4) generally preclude tax-exempt organizations and governmental entities from claiming the ITC. Section 50(b)(4)(D) provides special rules for partnerships with tax-exempt or governmental entity partners that mirror the rules in sections 168(h)(5) and (6). Those rules look through the partnership structure to the individual partners to apply the section 50(b)(3) and (4) limitations, clearly stating that "a tax-exempt entity's proportionate share of any property owned by a partnership shall be determined on the basis of such entity's share of partnership items of income or gain,"[127] and "an amount equal to such tax-exempt entity's proportionate share of such property shall . . . be treated as tax-exempt use property."[128] Thus, even where the partnership

[125] Although these regulations were temporary regulations when issued on July 22, 2016, they were finalized without additional preamble. We provide a more comprehensive overview of these rules in Part 4.5.1.2 of this comment.

[126] Income Inclusion When Lessee Treated as Having Acquired Investment Credit Property, T.D. 9776, 81 Fed. Reg. 47701, 47702 (July 22, 2016) (emphasis added). The Proposed Elective Pay Regulations include a statement that appears to be in conflict with this position, stating that "no election may be made under this section for any credits purchased pursuant to section 6418, transferred pursuant to section 45Q(f)(3), acquired by a lessee from a lessor by means of an election to pass through the credit to a lessee under former section 48(d) (pursuant to section 50(d)(5)), owned by a third party, or otherwise not determined with respect to the applicable entity or electing taxpayer." Prop. Treas. Reg. § 1.6417-2(c)(4). Similarly, the Proposed Transferability Regulations provide that "a section 45Q credit allowable to an eligible taxpayer because of an election made under section 45Q(f)(3)(B), or a section 48 credit allowable to an eligible taxpayer because of an election made under section 50(d)(5) and §1.48-4, although described in § 1.6418-1(c)(2), is not an eligible credit that can be transferred by the taxpayer because such credit is not determined with respect to the eligible taxpayer." Prop. Reg. § 1.6418-2(a)(4)(iii). However, the guidance does not explain how the existing regulations regarding the income inclusion rule are reconciled with these rules.

[127] Section 168(h)(6)(C)(i).

[128] Section 168(h)(6)(A)(ii).

itself is not a tax-exempt or governmental entity, the limitation still applies at the partner level to the partners that are.[129]

To be clear, we are not arguing that the "applicable entity" status of a partner should be attributed to the partnership. Rather, we argue that, consistent with longstanding section 702 authority and specific credit-related authority under section 50, Treasury has the authority to issue regulations providing that the tax credits derived by a partnership should be attributed to its partners and the partners should then apply the relevant credit utilization rules. If the partner is an applicable entity, then it should be able to obtain elective pay with respect to the attributed credit. Although section 6417(c)(1) provides that the partnership makes the elective pay election and receives the payment, Treasury could view this as an administrative rule, with the substance of the elective payment entitlement determined at the partner level, in accordance with the cited authorities under sections 702 and 50.

The second approach to allowing similar partnerships to make section 6417 elections—which is not necessarily mutually exclusive with the first—would rely on the broad regulatory authority granted to Treasury under section 6417(h), which directs the Secretary to promulgate regulations to carry out the purposes of the section, in conjunction with section 6417(c), which clearly contemplates that partnerships can make section 6417 elections as part of the purpose of the statutory scheme to expand the availability of elective pay to qualifying entities in order to effectively deploy the IRA credits. This approach may offer more flexibility than determining credits at the partner level. For example, Treasury could use this broad authority to provide a rule that arrangements that consist solely of applicable entities should themselves be treated as applicable entities. This may be a way to offer some administrative relief to applicable entities, without altering Treasury's general approach to partnerships in this guidance more broadly. The vast majority of applicable entities are tax-indifferent, and so tax administration concerns regarding allocations and certain other issues are substantially reduced under such an approach.

More generally, both of these approaches can be reconciled with the section 6417(c) requirement that the election be made at the partnership level, given that the Proposed Elective Pay Regulations apply the consolidated return rules under Treas. Reg. § 1.1502-77 to consolidated groups making an elective payment election under section 6417. Under those rules, the common parent of the consolidated group will make the elective payment election on behalf of its members even when the consolidated parent itself is not the entity that is eligible for elective

[129] If Treasury keeps in place a rule in the final regulations that states credits are determined with respect to the partnership rather than its partners, it could upend how the energy credit rules and limitations have been administered for more than twenty years and create confusion as to how the section 50(b)(3) and (4) limitations apply more generally. For example, applicable entities could reasonably take the position that a mixed partnership (e.g., a partnership with some partners that are tax-exempt or governmental entities) could generate an ITC and then sell the entire credit under 6418 without being subject to the section 50(b)(3) and (4) limitations. This would arguably be consistent with Treasury's theory that the credit is determined with respect to partnership (since the partnership in this case would not be a tax-exempt or governmental entity) but inconsistent with how the section 50(b)(3) and (4) limitations have historically applied. Treasury should avoid such confusion and instead write the final rules to be consistent with the statutory structure of sections 6417 (which specifically turns off the section 50(b)(3) and (4) limitations) and 6418 (which specifically does not).

payment. This is consistent with these alternative approaches for partnerships: eligibility for elective pay can be determined at the partner level, just as eligibility for elective pay in a consolidated group is determined at the member level. The entity making the election should not necessarily determine eligibility for elective pay, as the election may be a ministerial function.

The authority granted to Treasury by section 6417(h) enables it to issue regulations implementing elective pay, within the confines of the statute, that facilitate the purposes of the section.[130] This means that in addition to facilitating the deployment of clean energy by increasing the availability of IRA tax credits through elective payment, Treasury is able to consider factors such as the administrability of elective payment, limited audit and enforcement resources, and the potential for fraudulent elective payment when determining how to best carry out the purposes of this section.

Treasury's current interpretation of section 6417 would dramatically limit the flexibility for applicable entities to own credit property through partnerships, which is in tension with the clear purpose of the statutory scheme—to effectively deploy clean energy by allowing applicable entities to access the IRA credits through elective pay. As the preamble to the Proposed Elective Pay Regulations acknowledges, there will be a substantial demand for similar joint ventures of applicable entities to monetize renewable tax credits.[131] These arrangements enable applicable entities to cover capital needs for a number of reasons—for example, because a single entity does not have adequate funds for the entire project, because partnering with another entity enables access to certain grants or programs, or because entities can cover timing differences between capital outlay and return in the form of elective pay or power generation (filling a potential need for bridge financing). Such arrangements can also allow applicable entities to diversify risk or fill gaps in expertise without the risks or complications of engaging with non-applicable entities (generally, for-profit entities).

Extending elective pay eligibility to partnerships that are comprised solely of applicable entities presents little additional fraud risk. As described above, the clean energy industry commonly uses partnerships to monetize the value of tax credits and depreciation, and this structure has been endorsed by Treasury and IRS guidance.[132] Whether the elective payment is divided between two applicable entities, as opposed to one applicable entity, creates no additional risks to revenue. And, Treasury could also minimize the issue of potentially fraudulent elective payments even further in prefiling registration if needed—the filing requirements could be modified in the case of partnerships comprised solely of applicable entities (or with *de minimis* non-elective pay ownership), requiring a statement tailored to these arrangements.

Finally, extending elective pay eligibility to similar partnerships could also relieve tax administration burdens for both filers and the IRS. The due diligence process that applicable

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[130] *See* Part 3.1 of this comment.

[131] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40533-34.

[132] *See* Rev. Proc 2007-65, 2007-2 C.B. 967; Rev. Proc. 2020-12, 2020-11 I.R.B. 511. *See also* Martin, *supra* note 9.

entities would undergo in the process of deciding whether to enter into partnerships with other applicable entities can serve as an additional layer of diligence that could be beneficial for tax administrators. Elective payments could also be less complex to administer for similar partnerships as compared to tenancies-in-common or partnerships electing out of subchapter K treatment, since payments could be made to the entity level without relying on individual entities' representations as to their ownership percentages in qualifying property under Prop. Treas. Reg. §1.6417-2(a)(1)(iii).

### 4.3 Consider Allowing Section 6417 Elections for Credits Earned Through Mixed Partnerships

Treasury should also reconsider the treatment of partnerships that are comprised of both applicable and nonapplicable entities ("mixed" partnerships) prior to finalizing the regulations. As described above, Treasury's interpretation of the phrase "determined with respect to such entity" in section 6417(a) would foreclose the possibility of looking through to partners or shareholders[133] such that Prop. Treas. Reg. § 1.6417-2(a)(1)(iv) would largely exclude credits earned through mixed partnerships from elective pay eligibility.

We believe Treasury has authority to revisit this approach and instead look through to each partner's allocable share of the tax credit in determining elective pay eligibility. We believe this would be consistent with Treasury's prior statements that ITCs are "computed at the partner level based on partner level limitations" as well as the structure of sections 702 and 50(b)(3) and (4), as discussed in Part 4.2.2. As described in that Part, section 6417(c) clearly contemplates elective payments to partnerships, Treasury has broad authority to promulgate regulations to carry out the purposes of the section under 6417(h), and the purpose of the statutory scheme is to expand the availability of elective pay to qualifying entities in order to effectively deploy the IRA credits. If Treasury allows for section 6417 elections to be made on behalf of applicable entity partners, it should make conforming clarifications, including to clarify that the "applicable credit" that is reduced to zero under section 6417(e) is only the portion of the credit for which a section 6417 election has been made. Treasury should also clarify the appropriate application of section 6417(c)(1)(D) and make other clarifications as needed.

Allowing section 6417 elections to be made on behalf of applicable entity partners of mixed partnerships would also align with the access goals of the IRA. As described in the previous part, it would enable flexibility for capital outlays, facilitate greater exchange of expertise, eliminate the possibility of entities inadvertently entering into a tax partnership, and capitalize on the existing renewable tax credit industry structures set up to facilitate partnership transactions. Mixed partnerships could also be attractive to those applicable entities with extensive capital resources who want to avoid risks associated with direct property ownership and especially want to partner with for-profit entities due to their established track records and diligence expertise.

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[133] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40534.

Of course, sound compliance and administration is a central goal of the IRA. A larger group of entities eligible for elective pay could create a risk of more fraud (whether or not the newly-included entities create a higher risk of fraud than any other entities already included under Treasury's currently proposed approach). However, this could be potentially offset by partnering entities' ability to perform due diligence functions that could be helpful to tax regulators. Further, as noted above, other approaches to compliance—including robust use of pre-filing registration and other statutory tools—should in general be preferred to simply shutting off access where possible. Finally, we note that Treasury could provide rules similar to the tax-exempt use rules under section 168(h) to prevent the taxable partners from benefiting from a direct pay election.

## 4.4 Provide Additional Relief for Elective Payment Elections that Are Not Timely Filed

### 4.4.1 Background

Applicable entities will often be interacting with the tax system for the very first time. Procedural failures could lead to situations where applicable entities are disallowed credits, even though credit-eligible property has been placed in service in accordance with all substantive rules for the underlying credits. One area of concern relates to the timing deadline for making elective pay elections under section 6417. In this section, we recommend that Treasury allow applicable entities seeking elective pay to obtain a six-month extension pursuant to Treas. Reg. § 301.9100-2(b) in the event of late or incorrect elective pay elections.

The Secretary has broad discretion to determine the time and manner in which an elective pay election is made.[134] However, the statute provides some guidance on certain timing issues. First, the statute provides some absolute deadlines for making certain elections. For governments and political subdivisions thereof, the election deadline is as determined by the Secretary. For any other filer, the election must be made no later than "the due date (including extensions of time) for the return of tax for the taxable year for which the election is made . . . ."[135]

In the case of timing of a deemed payment (i.e., the deemed payment of tax that triggers the entitlement to a refund), section 6417(d)(4) provides that a payment by a government or political subdivision will be considered made on "the later of the date that a return would be due . . . or the date on which such government or subdivision submits a claim for credit or refund (at such time and in such manner as the Secretary shall provide)."[136] For all other entities, the payment will be treated as made on "the later of the due date (determined without regard to extensions) of the return of tax for the taxable year or the date on which such return is filed."[137]

[134] Section 6417(a) (providing that an election shall be made "at such time and in such manner as the Secretary may provide").

[135] Section 6417(d)(3)(A)(i)(II).

[136] Section 6417(d)(4)(A).

[137] Section 6417(d)(4)(B).

Prop. Treas. Reg. § 1.6417-2 offers detailed rules for making an elective pay election, including the manner of making an election and the timing of a deemed payment. Prop. Treas. Reg. § 1.6417-2(b)(1) provides that a filer makes an election on its tax return. In particular, Prop. Treas. Reg. § 1.6417-2(b)(1)(ii) specifies that an election may only be made on an original return that was filed on or before the due date (including extensions of time) for filing a tax return in the year for which the election was made, and an election cannot be made or revised on an amended return. Revisions made on a superseding return—a return field after the original return has already been submitted, but before the filing deadline (including extensions)[138]—will be considered made on an original return. The Proposed Elective Pay Regulations provide that elections cannot be made or revised on an amended return.[139]

While the deadline for making an elective pay election includes extensions, filers must proactively request such an extension unless an automatic extension is specifically provided. The Proposed Elective Pay Regulations, in their current form, helpfully make extensions automatic for certain applicable entities. However, this relief is limited. Under Prop. Treas. Reg. § 1.6417-2(b)(3)(i), subject to future guidance specifying how such an entity could request an extension, filers who are not required by sections 6011 or 6033(a) to file a return will be allowed "an automatic paperless six-month extension from the original due date . . . ." Effectively, unless or until future guidance is published outlining how applicable entities who do not traditionally file a return should go about requesting an extension, these groups—including State and local governments, territories, tribal governments, public utilities, churches, religious orders, and exempt organizations with gross receipts of $5,000 or less—will receive an extension automatically.

Prop. Treas. Reg. § 1.6417-2(b)(3)(ii), meanwhile, provides that "in the case of any taxpayer that is not normally required to file an annual tax return with the IRS (such as taxpayers located in the US territories), the due date (including extensions of time) that would apply if the taxpayer was located in the United States." This appears to mean that filers who may be required to file returns, just not with the IRS (for example, those required to file returns with a territorial government), will not receive an automatic extension.

Applicable entities who traditionally file returns, including colleges or universities described under section 170(b)(1)(A) and tax-exempt organizations with gross receipts exceeding $5,000 who traditionally file Form 990, are captured under Prop. Treas. Reg. § 1.6417-2(b)(3)(iii) and also do not receive an automatic extension. Prop. Treas. Reg. § 1.6417-2(b)(3)(iii) provides only that an elective pay election must be made no later than "the due date (including extensions of time) for the original return for the taxable year for which the election is made, but in no event earlier than Feb 13, 2023." So, unlike applicable entities who do not traditionally file a return,

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[138] IRS News Release IR-2022-130 (June 23, 2022) ("A superseded return is one that is filed after the originally filed return but submitted before the due date, including extensions.").

[139] *See* Prop. Treas. Reg. § 1.6417-2(b)(1)(ii).

those who do traditionally file can proactively request an extension before the deadline, but an extension will not be provided automatically.

Additionally, Prop. Treas. Reg. § 1.6417-2(b)(1)(ii) forecloses filers from seeking relief under the Filing Extension Regulations, which are used to grant an extension of time to allow a filer to make a regulatory election and provide automatic extensions of time for certain statutory elections. This includes barring relief under Treas. Reg. § 301.9100-2(b), which provides an automatic six-month extension from the due date of a return (excluding extensions) to make an election where a filer has timely filed a return for the year but has failed to make an election or has made an error when electing and wishes to take corrective action. While access to Treas. Reg. § 301.9100-2(b) "does not apply to regulatory or statutory elections that must be made by the due date of the return excluding extension," section 6417(d)(3)(A) specifically includes extensions, meaning this limitation would not impact the availability of relief under Treas. Reg. § 301.9100-2(b). Additionally, Treas. Reg. § 301.9100-2(b) is not limited to regulatory elections, as is the case for other remedies in the Filing Extension Regulations. Rather, Treas. Reg. § 301.9100-2(b) relief is permitted for statutory elections "whose due date is prescribed by the statute," as is the case for section 6417(d)(3).

### 4.4.2 Recommendation

As discussed in Part 3.1, there are strong administrative and access reasons to make some form of relief available in the section 6417 context that is consistent with the context and purposes of the IRA's climate tax and monetization provisions. Central to the need for relief is Congress's intent that the introduction of elective pay will bring new entrants into the clean energy marketplace. Many of these entrants have had little or no prior experience interacting with the federal income tax system and may lack tax expertise and sophistication, particularly if they are smaller or less experienced organizations (including those working in rural or underserved communities). These entities may face particular barriers to fully anticipating and understanding not only the steps they will need to take to successfully claim credits but also that they must make an election or correct a mistake through a timely superseding return (not by amending their return). This could leave these potential tax credit participants especially vulnerable to small mistakes with large consequences. For example, consider an applicable entity that properly pre-files and submits a Form 990-T by the normal return deadline, and then realizes after the deadline has passed that they made a mistake (for example, by inadvertently omitting one or more of its various registration numbers). This will mean a full loss of ITCs, and for tax-exempt entities a failure to properly elect a PTC in the year the applicable property is placed into service will impact not just that year's election but the entire stream of credits. In this case, there is no tax administration benefit to denying access to the credit, given that the IRS has already been notified of the intent to claim a credit through the pre-filing registration system.

Applicable entities who traditionally do not file a return will, under the Proposed Elective Pay Regulations, receive the automatic six-month extension discussed above unless future guidance specifies otherwise. Thus, the risk of losing an energy credit because of late filing or an error in making an election may be reduced for this group. If they fail to file by the original deadline, the

deadline is automatically extended. And if they make a mistake when they file, they will have an automatic six months within which to file a superseding return correcting the error. However, the regulation appears ambiguous regarding whether a return filed after the original due date, but within the automatic extension, is considered a superseding return. We recommend clarifying that that this would be considered a superseding return.

Applicable entities traditionally required to file a return, including those located in the US territories who file with territorial governments rather than the IRS,[140] would not receive an automatic extension of the filing deadline under the Proposed Elective Pay Regulations. If they fail to request an extension and submitted their filing after the deadline, these groups would be denied access to tax credits entirely (and tax-exempt entities attempting to claim a PTC would lose the credit not only for that year but for all future years as well). They would also lose the credit if they filed by the deadline and later realized they had failed to include a registration number for a specific property or included a registration number that is incorrect due to a transposition error. Unless they had proactively requested an extension despite an intention to file and claim an election by the deadline, they would be unable to correct their return to fix the election.

An additional potential trap for the unwary relates to delays in receiving registration numbers. All participating filers will also initially be dealing with the new pre-filing registration process, and navigating any complications this additional step introduces. While filers will generally understand that to claim an energy credit they must complete the pre-filing registration process, and while the Proposed Elective Pay Regulations provide information about the information filers may be asked to submit for each energy property in order to register such property, the Proposed Elective Pay Regulations do not provide clarity on how long it will take to receive a registration number. This lack of certainty creates the potential that filers may make costly miscalculations: if they underestimate how long it will take to receive a registration number, they could be caught without a registration number by the filing deadline.

Treasury has the authority to provide appropriate relief to allow filers who have acted in good faith to add or correct an elective pay election for a reasonable period after the deadline has passed. To do so, Treasury should reconsider the wholesale prohibition on access to the Filing Extension Regulations and should allow filers to request relief under Treas. Reg. § 301.9100-2(b), which provides an automatic six-month extension from the original due date for filing a return to allow filers who have filed by the filing deadline but have failed to make an election for one or more of their properties or have made a mistake in their election to take corrective action, as defined in Treas. Reg. § 301.9100-2(c). That provision defines corrective action as "filing an original or an amended return for the year the regulatory or statutory election should have been made and attaching the appropriate form or statement for making the election."[141]

[140] *See, e.g.,* Treas. Reg. § 1.935-1(b)(6) (providing that individuals filing a return in Guam and the Northern Marina Islands are relieved of their obligation to file a return in the United States).

[141] Treas. Reg. § 301.9100-2(c).

Allowing relief through Treas. Reg. § 301.9100-2(b) would solve four important problems: First, filers who traditionally file returns and as a result do not receive an automatic extension under the Proposed Elective Pay Regulations would be able to take corrective action, so long as they filed their return on time, to add or correct an incorrectly inputted election.

Second, this same group of filers would be able to look to Treas. Reg. § 301.9100-2(b) relief if they were unable to receive their registration number for one or more energy properties by the filing deadline. Even if the filer had not requested an extension ahead of time, so long as they filed their return by the deadline, they would be able to file a superseding return within the six-month period after the deadline had passed to add registration numbers for one or more properties for which they wished to make an elective pay election.

Third, providing Treas. Reg. § 301.9100-2(b) relief will ensure that filers located in territories who are not accustomed to filing a return with the IRS will be able to take corrective action if they make a mistake on their election or if they fail to elect—protecting them from facing unduly harsh consequences for small missteps and creating more parity between their treatment and the treatment of other groups that are unaccustomed to filing a federal tax return.

And fourth, allowing filers seeking to make or correct an elective pay election to access relief under Treas. Reg. § 301.9100-2(b) will ensure that if in the future regulations are issued that provide different procedures for filers who do not traditionally file returns to request extensions, these filers will still be able to add or correct an election within the six-month timeframe even if they no longer retain an automatic six-month extension. This will prevent future problems and ensure that filers receive similar treatment.

Treasury has the authority under section 6417 to provide some form of relief for filers. While section 6417 does tie deadlines explicitly to the timing of returns, there is no statutory language preventing Treas. Reg. § 301.9100-2(b) relief, or otherwise limiting whether filers may receive an extension of the deadline to file such that they can submit a superseding return. The best reading of the statute simply requires that the elective pay election be filed by the deadline, including extensions (which can be automatic), and that an election or correction to an election submitted within that timeframe will be allowed.

We recognize Treasury's desire to reduce late corrections and minimize requests under the Filing Extension Regulations. We also understand that allowing elective pay elections to be made or corrected in an amended return—one that is filed after the deadline, including extension—would create some administrative burdens for the IRS. However, we believe that providing an automatic six-month extension to filers who timely file their returns by the due date, as outlined in Treas. Reg. § 301.9100-2(b), will be administrable. This solution is tied to a predictable timeframe that aligns with the timeframe for processing returns for filers who request an extension and does not require the processing of additional request paperwork on behalf of a filer seeking an extension. Permitting this form of relief will also reduce other burdens that filers and the IRS may face, including (1) challenges related to delays in issuing registration numbers; (2) harsh and potentially arbitrary outcomes for applicable entities who make a small mistake in

their elective pay election; and (3) the downstream administrative burden for the IRS having to address non-compliance that could have otherwise been corrected with an amended return.

Providing a mechanism for relief may also have particular access benefits. It will allow less sophisticated applicable entities to feel more confident planning a project that hinges on receipt of an energy credit available through elective pay because it will lower the risk of making a correctable procedural mistake in good faith. This impact on access may be particularly important for lower-resourced applicable entities representing marginalized or underserved communities.

Access to relief will also promote equity across applicable entities attempting to make an elective pay election. Under the Proposed Elective Pay Regulations, applicable entities that do not traditionally file a return will receive an automatic six-month extension during which they can make or fix an election, while those that traditionally do file a return will not—creating different treatment amongst these groups. And filers located in the territories, who traditionally file with their territorial government rather than the IRS, will also not receive an automatic extension, creating yet another category of inconsistent treatment. By allowing Treas. Reg. § 301.9100-2(b) relief, all three groups will have an automatic six-month timeframe during which they will be able to make or correct an elective pay election.

Moreover, this solution still preserves slightly more favorable treatment for those who traditionally do not file a return at all: they will have an automatic six-month extension even if they have not yet filed a tax return, whereas Treas. Reg. § 301.9100-2(b) relief is only available for those who timely filed a return but failed to make an election or need to correct an error. This difference in treatment recognizes the difference in these groups' familiarity with the tax return process and preparation to engage in the elective pay election process, and it creates appropriate consistency between them. But, allowing Treas. Reg. § 301.9100-2(b) relief would help promote horizontal equity between for-profit entities with tax liability and appliable entities relying on elective pay. This is because for-profit entities with tax liability can add a credit on an amended return, while applicable entities—who can only take advantage of tax credits through elective pay—can only make an elective pay election to claim a credit on an original return. This creates a much more flexible and forgiving mechanism for for-profit entities to claim a credit than for exempt entities. Providing relief through Treas. Reg. § 301.9100-2(b) will increase parity between these groups by providing a pathway for exempt entities to add elections or make corrections.

### 4.5 Allow Certain Entities to Claim Elective Payment on Credits Purchased Under Section 6418

The Proposed Elective Pay Regulations disallow tax credit transferees from making an election under section 6417 with respect to transferred credits due to "several administrative and practical

reasons why making an elective payment election with respect to credits transferred under section 6418 would present challenges."[142] The preamble notes that:

> there is no restriction on who can be a transferee under section 6418, other than that the transferee cannot be related (within the meaning of section 267(b) or 707(b)(1) of the Code) to the eligible taxpayer transferring the credit. Thus, an applicable entity could be transferred credits under section 6418, at least to offset any Federal income tax liability. However, the statute does not address whether an applicable entity can make an elective payment election under section 6417 with respect to transferred credits.[143]

The preamble then proposes to prohibit transferee direct pay given Treasury's interpretation of the phrase "determined with respect to":

> [A] transferred credit is not properly interpreted as an applicable credit that is "determined with respect to" an applicable entity or electing taxpayer under section 6417(a) because the credit is not determined with respect to underlying applicable credit property owned by the applicable entity or electing taxpayer, or, if ownership is not required, activities otherwise conducted by the applicable entity or electing taxpayer.[144]

However, the preamble explicitly seeks "comments on limited situations where exceptions to this proposed rule may be appropriate because it is consistent with the text, design, and intent of the IRA, while also ensuring that such exceptions are not subject to fraud or abuse."[145]

In this section, we explain the statutory authority for allowing transferee elective pay as exceptions to the proposed general rule, including how allowing limited exceptions to the general rule is consistent with Treasury's approach to scoping the definition of "applicable entity" in the Proposed Elective Pay Regulations. We recommend limited exceptions that are consistent with the IRA's text, structure, and purposes including increasing credit access while ensuring compliance. We limit our comments to credits for which only applicable entities, determined without regard to sections 6417(d)(1)(B), (C), or (D), can make the election (i.e., not the credits under sections 45V, 45Q, or 45X). In other words, we discuss whether certain applicable entities should be able to make an elective payment election for tax credits transferred to them under section 6418.

### 4.5.1 Treasury Has the Authority to Permit Transferee Elective Payment in Limited Circumstances

Below we set out the sources of statutory authority for Treasury to permit transferee elective pay in the exceptional circumstances where compliance risks are low but doing so would enable

[142] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40538.

[143] *Id.*

[144] *Id.*

[145] *Id.* at 40539.

other key purposes of the IRA and the monetization provisions to be achieved. The statute clearly contemplates transferee elective pay in at least some exceptional circumstances, so completely prohibiting transferee elective pay would be at odds with the statutory text and structure. Exercising the statutory authority to provide exceptions in limited circumstances with low compliance risk is also the approach that is most consistent with how Treasury has implemented other parts of the Code and the IRA.

#### 4.5.1.1 The Text of the IRA Permits Exceptions to the General Prohibition of Transferee Elective Pay

Section 6418(f)(2) provides that the term "eligible taxpayer" (i.e., a taxpayer eligible to transfer credits) means any taxpayer "not described in [s]ection 6417(d)(1)(A)." Section 6417(d)(1) defines the term "applicable entity," which is an entity that may make an election for full elective pay under section 6417.[146] Putting these together, section 6418 specifies that an applicable entity cannot be a credit transferor but does not prohibit it from being a credit transferee. The fact that section 6418 explicitly prohibits an applicable entity from being a tax credit transferor but says nothing about an applicable entity being a credit transferee, creates a strong inference that an applicable entity can be a tax credit transferee. Congress demonstrated that it knew how to limit the scope of transferability, by generally preventing applicable entities from being transferors, through explicit language in section 6418(f)(2), and by disallowing related party transfers. Congress took no steps to limit who could be a transferee, and thus applicable entities eligible for elective pay may purchase credits under section 6418.

The "excessive credit transfer" statutory infrastructure also shows that the correct reading of section 6417 allows Treasury to permit transferee elective pay in at least some circumstances. Section 6418 provides that when the IRS determines that an excessive credit transfer has been made, there is an increase in "the tax imposed on the transferee taxpayer by chapter 1 (regardless of whether such entity would otherwise be subject to tax under such chapter)."[147] The parenthetical language would not be necessary unless Congress expected entities that are exempt from income tax to purchase credits.[148] And Congress could not have expected entities exempt from income tax to purchase credits without the ability to monetize them, i.e., obtain elective payment. Failing to give effect to the parenthetical would violate the canon against superfluity.[149] We have considered whether the parenthetical language was added for cases in which a partnership or other flow-through entity is a transferee. However, Treasury's approach to

[146] The proposed regulations have separate terms to define the two different types of entities eligible for elective payment. The proposed regulations would define the entities described in section 6417(d)(1)(A) as "applicable entities" and would reference entities making an election pursuant to sections 6417(d)(1)(B)-(D) as "taxpayers other than an entity described in" section 6417(d)(1)(A).

[147] *See* section 6418(g)(2)(A) (emphasis added).

[148] If this rule was meant to cover situations in which the additional tax is determined in a year in which the transferee does not owe tax, it could have been constructed differently. However, framing this rule as applying regardless of whether the transferee is "subject" to tax makes clear that this rule contemplates situations where an entity is—due to its status—exempt from tax under chapter 1.

[149] It is a principle of statutory interpretation that "if it can be prevented, no clause, sentence or word shall be superfluous, void, or insignificant." *TRW Inc. v. Andrews*, 534 U.S. 18, 31 (2001).

implementation appears potentially inconsistent with that interpretation. The Proposed Elective Pay Regulations make clear that a partnership is not, itself, an entity "exempt from the tax imposed by subtitle A" and thus is not directly eligible for elective pay.[150] Therefore, the parenthetical language in section 6418(g)(2)(A) is not necessary to apply the income inclusion for excessive credit transfers to partnerships.[151] Similarly, we have considered whether the parenthetical language is meant to apply when an applicable entity uses transferred credits to offset income tax on its unrelated business taxable income ("UBTI"). However, an entity's UBTI is determined under chapter 1, and so, the parenthetical would not be required in this case either.

Language in section 6418(a) also supports transferee elective payment. Section 6418(a) provides that, when a tax credit is transferred, "the transferee taxpayer . . . (and not the eligible taxpayer [i.e., the transferor taxpayer]) shall be treated as the taxpayer for purposes of this title with respect to" the transferred credit. Since the transferee is "treated as the taxpayer," and is an applicable entity under section 6417(d)(1)(A), it follows that the transferee can make an elective payment election with respect to the transferred credit, just as it could with a non-transferred credit. The "treated as the taxpayer" language puts the applicable entity that purchases a tax credit in the same position as if the applicable entity had earned the tax credit directly. Therefore, once an applicable entity acquires a credit—whether through direct activity or credit transfer—the statutory text supports the allowance of elective payment with respect to that credit. The preamble to the Proposed Elective Payment Regulations provides that the "Treasury Department and the IRS believe that a transferred credit is not properly interpreted as an applicable credit that is 'determined with respect to' an applicable entity or electing taxpayer under section 6417(a) because the credit is not determined with respect to underlying applicable credit property owned by the applicable entity or electing taxpayer, or, if ownership is not required, activities otherwise conducted by the applicable entity or electing taxpayer."[152] As we discuss in Part 4.5.1.2, this position conflicts with existing regulations applicable to certain ITCs.

We now turn to Treasury's general and specific relevant statutory authority to issue guidance. Treasury has broad authority under section 7805(a) to issue "all needful rules and regulations for the enforcement of [Title 26]." In addition, section 6417(h) and section 6418(h) both state that "[t]he Secretary shall issue such regulations or other guidance as may be necessary to carry out the purposes of this section . . . ." These enabling provisions provide ample authority for

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[150] While we agree that the better interpretation, especially given the structure of section 6417 and 6418 when read together, is that partnerships are not themselves applicable entities, we believe there is some statutory ambiguity on this issue. *See* section 701 ("A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.").

[151] Another way to give meaning to the parenthetical is to revisit the general prohibition against applicable entities making elective pay elections for property held through partnerships, as discussed in Parts 4.2 and 4.3. We have further considered whether the parenthetical relates to partnerships of electing taxpayers making partial elective pay elections. However, it would be a strained fit to say that partnerships are not "subject to tax" for purposes of section 6417(d)(6), but also are not exempt from tax for purposes of section 6417(d)(1). Two ways to reconcile this is to distinguish between the concepts of "subject to tax" and "exempt from tax," or to note that, perhaps there is a tax in chapters 2 through 6 of subtitle A that does apply to partnerships but does not apply to entities exempt under section 501.

[152] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40499-00.

Treasury to issue regulations permitting applicable entities (or a subset of applicable entities) to obtain elective payment under section 6417 for tax credits acquired under section 6418.

The preamble to the Proposed Elective Pay Regulations does not dispute that Treasury has authority to allow exceptions that enable transferee elective pay in certain limited circumstances, instead asking for "comments on limited situations where exceptions to this proposed rule [prohibiting transferee elective pay] may be appropriate." In explaining why Treasury proposes not to permit transferee elective pay, the preamble states that "[s]takeholders noted several administrative and practical reasons why making an elective payment election with respect to credits transferred under [s]ection 6418 would present challenges." It then goes on to set forth these reasons. Significantly, these reasons are administrative and do not go to statutory authority. We address them in Part 4.5.3 below.

Furthermore, the preamble acknowledges that "an applicable entity could be transferred credits under section 6418." It would be a strained fit with the text to conclude that an applicable entity could be a credit transferee but unable to monetize the transferred credits. It is not a sufficient answer that the applicable entity could use the credits to offset income tax on UBTI because governmental entities, as well as public utilities, are not generally subject to tax on UBTI and many, if not most, tax-exempt organizations have little or no UBTI. A more natural conclusion is that Congress intended for applicable entities to be able to obtain elective pay with respect to transferred credits in at least some circumstances.

#### 4.5.1.2 The Section 50 Regulations State that Energy Credits are Determined with Respect to the Credit Claimant, not the Owner or User of the Credit Property

As noted above, the preamble to the Proposed Elective Pay Regulations explains that applicable entities may not make an elective payment with respect to purchased credits under section 6418(a) because elective payment is only available for applicable credits "determined with respect to such entity." In interpreting this provision and prohibiting elective pay for purchased credits, Treasury makes the following statement:

> [T]he Treasury Department and the IRS believe that a transferred credit is not properly interpreted as an applicable credit that is "determined with respect to" an applicable entity or electing taxpayer under section 6417(a) because the credit is not determined with respect to underlying applicable credit property owned by the applicable entity or electing taxpayer, or, if ownership is not required, activities otherwise conducted by the applicable entity or electing taxpayer.[153]

This interpretation and the ensuing requirement, which we refer to as an "ownership or use" requirement, is just one of several approaches Treasury has taken when determining which person or entity a credit is "determined with respect to." As explained below, Treasury has taken an alternative approach in the income inclusion rules under Treas. Reg. § 1.50-1, opting instead

[153] Section 6417 Elective Payment of Applicable Credits, 88 Fed. Reg. at 40538-39.

to treat the person or entity who the energy credit benefits as the taxpayer that the credit is determined with respect to.

Section 50(c) provides that the basis of property for which an energy credit is determined will be reduced by 50 percent of the amount of the credit. However, in the case of a lessor who leases investment credit property to a lessee, the basis reduction rules change. Treas. Reg. § 1.48-4(a)(1) provides that the lessor may make an election to treat the lessee as having acquired the investment credit property, and if that election is made, Treas. Reg. § 1.50-1(b)(1) turns off the basis reduction rule. Instead, the lessee will include in gross income an amount equal to 50 percent of the energy credit (the "income inclusion amount") over the shortest recovery period applicable under the accelerated cost recovery system provided in section 168.[154] Importantly, Treas. Reg. § 1.50-1 provides special rules where the lessee of the investment credit property is a partnership or S corporation: the income inclusion amount is not an item of partnership or S corporation income; the partners or shareholders are treated as the ultimate credit claimants, not the S corporation or partnership; and the partners or shareholders must include in their gross income their respective portions of the income inclusion amount.[155]

As we noted in Part 4.2 of this comment, in the preamble to the temporary income inclusion regulations (which have since been finalized without material alteration on this point), Treasury provides the following explanation as to why the income inclusion should occur at the partner and shareholder level rather than at the partnership or S corporation level:

> The Treasury Department and the IRS believe that, **because the investment credit and any limitations on the credit itself are determined at the partner or S corporation shareholder level**, it is appropriate that the income inclusion occurs at the partner or shareholder level. In the case of a partnership that actually owns the investment credit property, **a partner in a partnership is treated as the taxpayer with respect to the partner's share of the basis of partnership investment credit property** under § 1.46-3(f)(1) and separately computes the investment credit based on its share of the basis of the investment credit property. Similarly, in the case of a lessee partnership where the lessor makes an election under § 1.48-4 to treat the partnership as having acquired investment credit property, **each partner in the lessee partnership is the taxpayer with respect to whom the investment credit is determined under section 46**. Each partner in the lessee partnership will separately compute the investment credit based on each partner's share of the investment credit property. The credit is therefore computed at the partner level based on partner level limitations.[156]

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[154] Treas. Reg. § 1.50-1(b)(2)(ii).

[155] Treas. Reg. § 1.50-1(b)(3)(i).

[156] Income Inclusion When Lessee Treated as Having Acquired Investment Credit Property, 81 Fed. Reg. at 47702 (emphasis added). The Proposed Elective Pay Regulations include a statement that appears to be in conflict with this position, stating that "no election may be made under this section for any credits purchased pursuant to section 6418,

**Treasury's reasoning here makes clear that ownership and use are not necessarily dispositive in determining whether a credit is "determined with respect to" a person or entity.** To the contrary, under the income inclusion regulation, when a lessor elects to treat a partnership lessee as having acquired the leased energy property, the regulations operate so that the ITC is determined with respect to the partner notwithstanding that the partners do not own or use the energy property at all. Treasury further states in the preamble that this is consistent with the principle that "the burden of income inclusion should match the benefits of the allowable credit."[157] Thus, in this case, the credit claimant, and not ownership or use of the underlying energy property, controls who the credit is "determined with respect to."

We do not aim, in this comment, to decide whether an ownership or use requirement (the rule in the Proposed Elective Pay Regulations) or a benefit requirement (the rule in the income inclusion regulations) is most appropriate when analyzing who a credit is "determined with respect to" for purposes of elective pay eligibility. Instead, we highlight that these competing approaches, at a minimum, indicate that Treasury has considerable discretion to interpret the words "determined with respect to such entity" to permit exceptions for transferee elective payment where the exception would fulfill the purpose of the statute. Here, the purposes of the IRA, which include creating a robust market for transferability, would potentially be well served by creating limited exceptions for certain entities to purchase credits and make elective payment for those credits.

#### 4.5.1.3 There Is Precedent for Uses of Authority Consistent with Limiting Transferee Elective Pay to Exceptional Circumstances

The preamble specifically requests "comments on limited situations where exceptions to this proposed rule may be appropriate because it is consistent with the text, design, and intent of the IRA, while also ensuring that such exceptions are not subject to fraud or abuse," including legal considerations. In this subpart, we focus on Treasury's legal authority to limit transferee elective pay to certain exceptional circumstances, and why the statute does not restrict Treasury to a polar choice of either fully disallowing, or fully allowing, transferee elective pay.

In other contexts, Treasury has correctly read clear and broad authority to permit exceptions or applications of rules to some entities but not others based on compelling administrative and

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transferred pursuant to section 45Q(f)(3), acquired by a lessee from a lessor by means of an election to pass through the credit to a lessee under former section 48(d) (pursuant to section 50(d)(5)), owned by a third party, or otherwise not determined with respect to the applicable entity or electing taxpayer." Prop. Treas. Reg. § 1.6417-2(c)(4). Similarly, the Proposed Transferability Regulations provide that "a section 45Q credit allowable to an eligible taxpayer because of an election made under section 45Q(f)(3)(B), or a section 48 credit allowable to an eligible taxpayer because of an election made under section 50(d)(5) and § 1.48-4, although described in § 1.6418-1(c)(2), is not an eligible credit that can be transferred by the taxpayer because such credit is not determined with respect to the eligible taxpayer." Prop. Treas. Reg. § 1.6418-2(a)(4)(iii). However, the guidance does not explain how the existing regulations regarding the income inclusion rule are reconciled with these rules.

[157] *Id.*

statutory purpose rationales.[158] Treasury takes a similar approach in the Proposed Elective Pay Regulations. One relevant example is in the proposed definition of "applicable entities." While the statute states that "*any* organization exempt from the tax imposed by subtitle A" is an applicable entity, Treasury has narrowed the list of such entities to only include those exempt under section 501(a). This excludes other entities exempt under subtitle A, such as homeowners associations exempt under section 528, notwithstanding language in section 528 stating that "[a] homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes."[159] This is an appropriate use of the broad grant of authority under section 6417(h).

That is, the broad authority in the IRA supports Treasury taking reasonable approaches to the implementation of the elective pay regime, based on tax administration and other considerations. Treasury is not limited to the binary choice of either disallowing, or allowing, transferee elective pay in all circumstances. The final regulations can allow transferee elective pay in limited, appropriate circumstances, and should do so when that would best achieve the purposes of the IRA and its monetization provisions as discussed in Part 3.1 of this comment.

#### 4.5.2 The Structure and the Purpose of the IRA Support Treasury Exercising its Regulatory Authority to Develop Exceptions Allowing Transferee Elective Pay for Applicable Entities when There Is a Low Fraud Risk

Ensuring compliance and preventing fraud and abuse is one of the IRA's key statutory goals. Widespread fraud or abuse would undermine the integrity of the tax system, could result in revenue loss that reduces the efficiency of the IRA tax credits, and could undermine rather than support the emissions reduction, access, and equity goals of the IRA.

The preamble to the Proposed Elective Pay Regulations appropriately considers this by asking whether there should be exceptions only for certain types of entities posing low risk of fraud or abuse. The preamble asks stakeholders to consider certain criteria for determining exceptions, including the involvement of the transferee in the project's development; the level of due diligence conducted by the transferee; whether the transferee is paying close to the face value of the credit; and whether there are other special financial arrangements between the parties increasing the risk of fraud or abuse.

Broadly, the situations suggested for feedback are those where there may be a particular ability to leverage the nature of the transferee, transferor, or, especially, the market between them to

[158] For example, Treasury has exercised its rulemaking authority to wholly exclude governmental entities from the intermediate sanction regime under section 4958 given those entities' exempt status under section 115 and the safeguards already in place preventing private inurement. An excess benefit transaction is one where a "disqualified person" receives consideration in excess of the economic benefit provided to an "applicable tax-exempt organization," which is taxable to the disqualified person at 25 percent of the excess benefit. An applicable tax-exempt organization is generally one described in sections 501(c)(3) and (4), but Treasury has excluded governmental entities who are also (c)(3) or (c)(4) organization (mainly colleges and universities) from this definition.

[159] Section 528(a). There are other entity types with similar language as well, including political organizations described in section 527.

better ensure compliance. This is a sound way to consider what exceptions are appropriate, because it aligns with a key structural decision in the IRA: one of the law's main compliance tools is to leverage private market activity and relationships between a buyer and seller of a credit by making the transferee of credits liable when a credit is not properly determined.

Based on those criteria and that statutory structure, we recommend that Treasury consider exceptions for the following transferee entities:[160]

- State and local governmental entities purchasing credits from transferors or with respect to projects within their jurisdiction.[161]
- Quasi-governmental entities, such as state housing finance agencies and certain green banks.
- Public power entities that are also purchasing power from the transferor.
- Specific classes of tax-exempt entities with both (1) particular market skills; and (2) purposes for participating in the credit purchase market that aligns with the purposes of the IRA ("mission-relevant tax-exempts"). These could include classes of entity such as tax-exempt community development financial institutions (CDFIs).[162]
- Applicable entities purchasing credits with an allocated component—specifically a section 48C or 48(e) credit (both of which require an application).
- Transferee elective pay for these entities and circumstances poses lower risk of fraud or abuse than for others because of the market relationships between the buyer and seller or because of the nature of the entities, and would be especially well-aligned with the purposes of the IRA.[163]

State and local governments do not pose the same fraud or abuse risks as other tax-exempt organizations. Governments have public purposes. They also have regulatory authority over activities within their boundaries that is likely to give them access to information over economic activities in the jurisdiction. In some cases, the transferor may have been established by the governmental entity itself. Governments are more likely to have the resources to diligence the credits and address indemnity issues, and they have a recognized role in promoting economic

[160] Another approach would be to allow all applicable entities to qualify for transferee elective pay but to apply more rigorous compliance standards to entities other than ones listed here. This approach would be more inclusive than excluding certain categories of tax-exempt entities, but more challenging in terms of policing fraud and abuse.

[161] We would include territory governments, the Tennessee Valley Authority, Indian tribal governments, Alaska Native Corporations, and rural electrical cooperatives (all specifically referenced in section 6417(d)(1)(A)) in this category.

[162] CDFIs may be taxable or tax-exempt. Taxable CDFIs could be credit purchasers but could not obtain elective pay.

[163] In the case of applicable entities purchasing allocated credits under sections 48C and 48(e), these factors are not present, but we believe that the risk of potential fraud is mitigated by the fact that these credits require substantial information to be submitted before a credit is allocated, substantially reducing the risk of fraud.

development within their jurisdictions.[164] State and local governments are also more durable, and thus more easily subject to enforcement, than other tax-exempt organizations.

Access for State and local governmental entities has been one of the key challenges that lawmakers have sought to incrementally address with access to energy tax incentives, given that such entities are potentially important market participants for deployment and access aims, and given their role in understanding and serving local community needs through both fiscal and regulatory actions. Similarly, the other categories of applicable entities that we recommend for an exemption have specific public interest purposes or roles that are especially well-aligned with the purposes of the IRA. As tax credit purchasers, certain applicable entities are likely to be sensitive to local community needs. They are also likely to facilitate projects that provide collateral benefits, such as infrastructure or projects with other broader positive community and economic spillovers.

Quasi-governmental entities are similarly more likely to be durable, and well-equipped to conduct diligence. Certain of them, including state housing finance agencies, also have purposes and conduct activities that are highly aligned with the deployment, access, and equity goals of the IRA. If Treasury determines that fraud risk can be mitigated by limiting purchases of credits for governmental and quasi-governmental entities to cases where the credit property has a geographic connection to the applicable entity, restricting transferee elective pay on a similar basis may be appropriate.

Public power entities who are purchasing clean power from a credit-eligible project (for example, through a Power Purchase Agreement) have particularly strong market relationships with the developer producing electricity (and generating a credit). A public power entity purchasing power from a facility will also have information regarding certain bonus credit amounts, including whether the facility is located in an energy community.

Another group of candidates for transferee elective payment are certain specific classes of tax-exempt entities whose activities mean they are likely to have both (1) particular market role and skills in evaluating clean energy tax credits and the underlying transactions that would reduce compliance risk; and (2) a strong rationale for participating in the credit purchase market that aligns with the purposes of the IRA. Treasury could offer an enumerated list of these types of entities eligible for exemption, which could include:

- Tax-Exempt CDFIs. CDFIs can play an important role in economic development in underserved communities.[165] Many CDFIs offer financing for clean energy projects in these communities. These are appropriate factors in determining whether they are "mission-relevant" for purposes of this potential exception. Further, CDFIs already have

[164] Governmental entities are also well positioned to pay an amount closer to face value for credits than other types of applicable entities, especially those governmental entities looking to subsidize clean energy deployment in their jurisdictions.

[165] *See* 18 CFR § 1805.201(b)(1) ("A CDFI must have a primary mission of promoting community development. In determining whether an entity has such a primary mission, the CDFI Fund will consider whether the activities of the entity are purposefully directed toward improving the social and/or economic conditions of underserved people (which may include Low-Income persons or persons who lack adequate access to capital and/or Financial Services) and/or residents of economically distressed communities (which may include Investment Areas).").

some regulatory certification and oversight and thus are more likely to meet the broad public interest goals of the IRA and allow leveraging of existing compliance frameworks. CDFIs can also be readily and objectively defined, since a definition could be restricted to those that have received certification by the CDFI Fund.

- Green banks (and green bank-like entities).[166] Broadly speaking, green banks employ public funds to catalyze private sector investment in clean energy and energy efficiency projects. Often, green banks are organized as part of a State or city government. But green banks can also be organized as quasi-governmental entities or tax-exempt organizations. Green banks can deploy capital and offer other support to accelerate deployment of clean technologies. Often, this is done with a focus on underserved communities.[167] Therefore, they may be considered "mission-relevant" as well. As green banks (and green bank-like entities) are more difficult to define than CDFIs, Treasury could consider a conceptual definition, or could, in consultation with the EPA, develop a list of qualified green banks.

In short, Treasury should consider whether tax-exempt CDFIs and green banks (and green bank-like entities) should be eligible for an exception allowing transferee elective pay. These entities have relevant missions and expertise and community accountability, in the case of CDFIs, via certification through Treasury.

There may well be additional tax-exempt organizations (or classes of organizations) that are reputable, pose low risk of fraud or abuse, play a role that meshes well with being a credit purchaser, and have (or can obtain) the skills necessary to perform due diligence on transferred tax credits—and therefore are appropriate candidates for transferee elective pay. Treasury could initiate a rulemaking process enabling such organizations to make their case to be included in the class of organizations qualifying for transferee elective pay.

Treasury should also consider allowing transferee elective pay where a transferee is purchasing a credit that has been allocated by the Treasury Department. Specifically, this would apply to tax credits under section 48(e) (the Low-Income Communities Bonus Credit) and 48C (the Qualifying Advanced Energy Project Credit). These credits already require significant pre-allocation documentation to be submitted to the government. Our understanding from stakeholder discussions is that many section 48(e) credit applicants will likely lack sufficient tax capacity to claim credits on their own return. If a vertical slice of a credit stack is transferred, we believe it is appropriate to allow transferee elective pay on the entire credit stack, because the Proposed Transferability Regulations do not allow selling off bonus credits apart from other portions of a credit.

In short, in these exceptional circumstances, in addition to compliance risks being lower, the access aims of the IRA monetization provisions and the IRA are most compelling. More

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[166] Certain green banks may be covered by rules that apply to quasi-governmental entities more broadly.

[167] The EPA describes green banks as generally sharing the "following key features: They are mission-driven financing institutions. They have a mandate to advance the deployment of clean energy. They leverage their funds to stimulate private capital. They offer products across sectors and focus on bridging market gaps." *See* Green Banks, EPA (last accessed August 10, 2023).

broadly, allowing exceptions for some or all of these entities should increase the efficiency of transfer tax credit markets. It would also ensure that tax credit purchase markets include certain additional purchasers with lower compliance risk and the ability to access the economic value of credits regardless of macroeconomic conditions. Establishing a higher floor on clean energy development during recessions is a key consideration seen in the history and development of the IRA's monetization provisions, as discussed in Part 3.1.

### 4.5.3 Administrative and Practical Reasons for Prohibiting Transferee Elective Payment Can Be Addressed

The preamble to the Proposed Elective Pay Regulations discusses "several administrative and practical reasons why making an elective payment election with respect to credits transferred under section 6418 would present challenges." The preamble specifically requests comments related to transferee elective pay to address these challenges. Here we describe the specific challenges raised, and how limited exceptions allowing transferee elective pay can address them.

The preamble to the Proposed Elective Pay Regulations notes a stakeholder contention that the elective payment election under section 6417(i) with respect to a section 45 or section 45Q credit, applies only to property placed in service after December 31, 202 and (ii) with respect to a section 45V credit, applies only to clean hydrogen attributable to property placed in service after December 31, 2012, whereas there are no such restrictions under section 6418. This "inconsistency" could be addressed by providing that when these credits are transferred to applicable entities and the elective payment election is made, the more restrictive section 6417 placed in service rule would apply.

Another stakeholder contention is that section 6417(d)(3)(ii)'s requirement that a section 6417(a) election be "irrevocable" would seem to prohibit an applicable entity from making a section 6417(a) election for any credit for which the section 6417(a) election spans more than one year (e.g., credits under sections 45, 45Q, 45V, and 45Y) because elections under section 6418 are annual and the transferee does not own the property or engage in the activities giving rise to the credits. However, the transfer election under section 6418 is also "irrevocable" under section 6418(e)(1), so the annual nature of the election should not prevent it from being deemed "irrevocable" under section 6417(d)(3)(ii). Moreover, the elective pay election would, in fact, be irrevocable with respect to the annual portion of the credit the transferee receives.

A third stakeholder contention is that a transferee's ability to purchase only a portion of a credit is arguably inconsistent with the section 6417(a) requirement that the elective payment election must be with respect to the entire credit for the relevant property for the taxable year. This contention could be addressed by limiting the elective payment election, in the case of transferred credits, to transfers of entire credits.

Finally, the preamble notes that "the pre-filing registration process contemplated by section 6417(d)(5) and by section 6418(g)(1) is not currently designed to allow an applicable entity purchasing eligible credits under section 6418 to make an elective payment election under section 6417." But these sections give Treasury very broad authority to design the system, and we believe it is feasible to develop a portal and filing system that accommodate transferee elective pay. The information needed to determine a credit is largely the same, regardless of

whether the filer owns the relevant property directly. Therefore, we recommend that, if Treasury adopts limited exceptions allowing transferee elective pay in appropriate circumstances, that the IRS update the portal accordingly. We would further recommend considering ways to streamline pre-filing registration, since much of the relevant information for processing an elective pay election would have already been submitted by the transferor in its pre-filing submission.

Furthermore, as set out in Part 3.1, the legislative context, text, and structure of the IRA strongly suggest that to address compliance concerns and administrative challenges, Treasury should first use the explicit tools provided to it in the IRA and elsewhere in the tax system before limiting access to tax credits due to challenges that occur in limited circumstances.

### 4.6 Prioritize Guidance for Applicable Entities Seeking Exceptions to the Domestic Content Requirements when Claiming the Generation Credits

We recommend that Treasury prioritize issuing clear guidance on the domestic content elective pay requirements and exceptions. Implementing the IRA is an enormous undertaking, and Treasury has prioritized much of the most important guidance**,** including issuing the Proposed Elective Pay and Proposed Transferability Regulations. Going forward, Treasury should additionally consider prioritizing guidance implementing domestic content exceptions for applicable entities, given that (1) these requirements go into effect for projects commencing construction in 2024, (2) these rules ultimately relate to whether the credits can be accessed at all, rather than whether a bonus is available, and (3) project planning may be delayed while these rules are pending. We understand that prioritizing this guidance may mean delays in other important guidance.

In this section, we discuss how exceptions for the domestic content requirements for elective payments of the generation credits could be implemented. We begin with a description of the statutory text and Treasury's statutory authority, before turning to a discussion of how the novelty of the domestic content provisions in the tax system context create some significant challenges for the IRS and Treasury in administering the domestic content exceptions.

The US tax system relies on voluntary compliance. Business tax credits are one part of the system that relies heavily on "self-certification" on the tax return, combined with the potential for and use of audits. Using this approach for the domestic content exceptions could permit more deliberate abuse of the exceptions than is consistent with the goals of the domestic content requirements. It could also lead to compliance burdens on honest applicable entities attempting to follow the law regarding the domestic content rules but making non-willful errors. On the other hand, the use of some type of "pre-approval" process is seen only in very limited contexts in the tax system. If implemented on a project-by-project basis for the domestic content exceptions, such a process could create resource demands on the IRS that undercut other aspects of IRA implementation and sound tax system administration more broadly. It is a daunting

challenge to determine how to implement the exceptions in a way that avoids or minimizes some of these undesirable outcomes.

With these challenges in mind, we outline some potential goals for implementing domestic content exceptions. We suggest Treasury consider some approaches to implementing clear and administrable exceptions, and doing so in ways that will provide information to market players (and policymakers) that they would need to identify and fill domestic supply gaps that are driving common exceptions being claimed and granted.

### 4.6.1 Statutory Framework of the Domestic Content Requirements and Exceptions

First, we discuss the statutory framework. The generation credits impose a haircut on elective payments for generation credits if the underlying facility or property has a maximum output of 1 megawatt or more and does not meet domestic content requirements.[168] An applicable entity making an elective pay election receives a credit equal to the value of the credit multiplied by the "applicable percentage."[169] Elective payments for generation credits stemming from projects that begin construction in 2024 will equal 90 percent of the underlying credit (in effect, a 10 percent haircut) if the project fails to meet the domestic content requirements and has an output of 1 megawatt or more because the applicable percentage would be 90 percent.[170] Elective payments for 1 megawatt or greater projects not meeting the domestic content requirements are subject to a haircut of 15 percent if the underlying projects begin construction in 2025 and are eliminated entirely if the projects begin construction in 2026 or later.[171] This credit phaseout for failing to meet domestic content requirements only affects applicable entities. Filers who do not make section 6417 elections and fail to satisfy the domestic content requirements will not receive the domestic content bonus credit but will receive their full base credit. The statutory exceptions to the domestic content rules are not relevant for the domestic content bonus credit.

To meet the domestic content requirements, a filer must certify to the Secretary that "any steel, iron, or manufactured product which is a component of such facility (upon completion of construction) was produced in the United States (as determined under section 661 of title 49, Code of Federal Regulations [the Federal Transit Administration's (FTA's) Buy America requirements])."[172] The steel or iron requirement is met if all of the steel or iron items' manufacturing processes took place in the US (other than certain metallurgical processes).[173] The

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[168] Sections 45(b)(10), 45Y(g)(12), 48(a)(13) (stating that rules similar to section 45(b)(10) apply), and 48E(d)(5) (stating that rules similar to section 45Y(g)(12) apply). In the remaining footnotes in this section, we do not repeat the sections 48(a)(13) and 48E(d)(5) cross-references to sections 45(b)(10) and 45Y(g)(12).

[169] Sections 45(b)(10)(A) and 45Y(g)(12)(A).

[170] *See* section 45(b)(10).

[171] Section 45Y(g)(12).

[172] Sections 45(b)(9)(B)(i), 45Y(g)(11)(B)(i), 48(a)(12)(B) (stating that rules similar to section 45(b)(9)(B) apply), and 48E(a)(3)(B) (stating that rules similar to section 48(a)(12) apply).

[173] Notice 2023-38, 2023-22 IRB 872, section 3.02.

manufactured products requirement is met if all manufactured products are produced in the US or deemed to be produced in the US.[174] The manufactured products that are components of a facility are deemed to have been produced in the US if a certain percentage (the "adjusted percentage") of the total costs of all manufactured products of the facility are attributable to manufactured products mined, produced, or manufactured in the US.[175]

The generation credits provide that the Secretary "shall provide exceptions to the [domestic content elective pay] requirements" under two circumstances: (1) if the inclusion of domestically produced products "increases the overall costs of construction of qualified facilities by more than 25 percent" or (2) if "relevant steel, iron, or manufactured products are not produced in the United States in sufficient and reasonably available quantities or of a satisfactory quality."[176] If the Secretary provides an exception, "the applicable percentage shall be 100 percent," meaning the applicable entity receives the full generation credit via elective pay.[177]

The statute gives Treasury broad authority to implement these exceptions to the domestic content requirements for elective pay. Section 45(b)(12) gives the Secretary broad authority to "issue such regulations or other guidance as the Secretary determines necessary to carry out the purposes of this subsection." Section 45Y(f) provides slightly narrower, but still substantial, authority stating that "the Secretary shall issue guidance regarding implementation of this section." Treasury thus has expansive authority to implement the domestic content exceptions in a manner that carries out the purposes of the statute.

Treasury has yet to publish guidance implementing the domestic content elective pay requirements and exceptions but should prioritize doing so. An applicable entity may take years to plan, construct, and place in service a generation project. Importantly, there are steps that must be taken before construction can commence. In order to plan properly, especially in the pre-construction phase, applicable entities must understand the rules that will apply to ensure certainty regarding the amount of credit they can expect with respect to the project. The domestic content elective pay haircut affects 1 megawatt or greater generation projects that begin construction in 2024, and such projects that begin construction in 2026 or later will receive no elective payment at all if they fail to meet the domestic content requirements.[178] Given the substantial financial implications of complying with the domestic content requirements, applicable entities need clarity on how the exceptions will work as soon as possible.

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[174] Notice 2023-38, 2023-22 IRB 872, section 3.03(1).

[175] Section 45(b)(9)(B)(iii); *see also* Notice 2023-38, 2023-22 IRB 872, section 3.03(2).

[176] Sections 45(b)(10)(D)(i) and 45Y(g)(12)(D)(i).

[177] Sections 45(b)(10)(D)(i) and 45Y(g)(12)(D)(i).

[178] *See* sections 45(b)(10)(C)(ii) and 45(g)(12)(C)(iv).

In this comment we do not offer any substantive position on the vigorously debated policy merits of domestic content preferences or the domestic content bonus credit.[179] Lawmakers have written exceptions to the domestic content requirements for elective pay into the statute, and our interest in commenting on these exceptions is in offering ways to administer those provisions that are consistent with the statute and sound tax administration and compliance principles. We are proactively commenting on this issue because, without additional clarity and guidance, the statutory exceptions as written will be difficult to implement in a way that allows entities to ensure they comply with the domestic content requirements and that makes administration feasible.

### 4.6.2 Proposed Tax Administration Goals for Implementing the Domestic Content Exceptions for Elective Pay

The domestic content statutory exceptions pose significant challenges for tax administration and applicable entities. Treasury and the IRS have very limited expertise in administering domestic content preferences. Regardless of how Treasury and the IRS choose to implement the domestic content exceptions, they will need to develop that expertise and, potentially, draw on the expertise of other agencies. In addition, unlike the federal financial assistance programs that are typically subject to domestic content preferences, the generation credits are not capped and allocated, meaning the potential universe of those seeking an exception could be quite large. Treasury will therefore need to carefully implement the exceptions to prevent the administrative burden for the IRS from becoming unmanageable in ways that could affect its administration of other provisions of the IRA tax credits or tax provisions more generally. In addition, as discussed above, many applicable entities are new entrants to the income tax system and have likely never had to meet domestic content requirements before. Given these difficulties, developing a clear and workable process to administer domestic content exceptions will require extensive time and effort.

Furthermore, the usual approaches to tax compliance could have serious downsides for the purposes of the IRA and the tax system. Therefore, the IRS will likely need to build not just expertise, but also a new administrative apparatus to administer the domestic content exceptions. That is a heavy undertaking that will likely take years to refine.

"Self-certification" or "voluntary compliance" is effectively the approach the IRS takes for administering much of the Code.[180] This could be a poor fit for administering the domestic content exceptions given the noncompliance risks it raises. In a self-certification regime, applicable entities with 1 MW or larger projects would simply attest that they qualified for an

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[179] *See, e.g.*, Kat Lucero, *Sens. Say Green Energy Domestic Content Rules Lack Teeth*, Law360 (May 15, 2023); Lydia DePillis, *Energy Tax Credits, Meant to Help U.S. Suppliers, May Be Hard to Get*, New York Times (June 9, 2023).

[180] *See generally* section 6001 ("Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.") and the regulations issued pursuant to section 6001.

exception when filing for a generation credit. On audit, they would be expected to produce evidence substantiating their self-certification. Self-certification could open the door for some entities to take aggressive positions when self-certifying, leading to uneven compliance. In addition, self-certification could introduce unintentional noncompliance, as applicable entities would need to determine for themselves whether their project qualified for a domestic content exception. Some applicable entities may be unable to evaluate their own eligibility for an exception appropriately, despite their best efforts. This could result in burdensome audits for applicable entities who attempted to comply with the exceptions in good faith but were without a mechanism for upfront certainty. While this dynamic is a concern across the tax system, it may be a particular concern within the context of a regime that is bringing new entities into the system and doing so with a purpose of encouraging certain types of investment. These concerns may be especially acute for governmental entities because audit risk will often arise in a different budget year than when the credit is determined or claimed. An audit could result in the governmental entity having to pay back the credit plus a penalty in a later year when they do not have the budget flexibility to do so. Furthermore, Treasury and the IRS will need to provide some guidance here, as the statute instructs the Secretary to provide exceptions, and it is unclear whether any exceptions could be self-executing.

Alternatively, pre-approval processes on a "project-by-project" basis are uncommon in the tax system. Attempting to adopt such a system in this case could undercut not only IRA implementation more broadly but also other tax administration efforts, including full implementation of the SOP. The IRS uses private letter rulings ("PLRs") to provide pre-approval for certain tax determinations,[181] and some might look to the PLR model to administer the domestic content exceptions. In a PLR, the IRS "applies tax laws to [a] taxpayer's represented set of facts."[182] A PLR is issued in response to a taxpayer's request and cannot be used as precedent for other taxpayers or the IRS.[183] Using PLRs to administer domestic content exceptions would result in an overwhelming volume of work for the IRS. As discussed above, the potential universe of applicable entities who want domestic content exceptions, at least initially, may be exceptionally large. Each applicable entity seeking an exception would need to request a PLR from the IRS and would need to make multiple requests if it owned multiple projects seeking exceptions. The IRS, in turn, would need to respond individually to each request. Even if the IRS could handle the sheer volume of requests, it likely lacks the expertise in the near term to review requests on a project-specific basis. In addition, PLRs are not designed to resolve factual matters. When a taxpayer requests a PLR, they are seeking to understand how to apply the law to a set of facts. With a domestic content exception, the facts themselves are at issue (i.e., whether an item is unavailable or whether the inclusion of domestic material increases the overall costs of construction by more than 25 percent). Given these considerations, PLRs are

[181] IRS, Understanding IRS Guidance - A Brief Primer (last accessed August 10, 2023) ("Understanding IRS Guidance").

[182] IRS, Tax Exempt Bonds Private Letter Rulings: Some Basic Concepts (last accessed August 10, 2023).

[183] IRS, Understanding IRS Guidance, *supra* note 181.

not a workable option for administering the domestic content exceptions. Instead, a new apparatus is likely necessary.

The IRS developed a system separate from the PLR process to handle the largely factual determinations involved with advance pricing agreements ("APAs"), the Advance Pricing and Mutual Agreement Program ("APMA"). APMA requires filers seeking an APA to submit extensive documentation supporting their application,[184] and determinations can take the IRS years.[185] APMA is an example of the IRS developing a new process to handle the specific challenges of a given tax issue, and such a separate system may be appropriate for administering the domestic content exceptions. However, a system similar to APMA would have the same drawback as a PLR process—namely, the potential for a very high volume of requests. In addition, though transfer pricing agreements may be more complicated than the domestic content exceptions, the IRS's experience with APMA suggests that individualized factual determinations for the domestic content exceptions could require substantial resources.

While these challenges are significant, as noted above, Treasury has broad authority that allows it to choose among a wide range of possible approaches to administering the domestic content exceptions, such as an individualized application process, categorical exceptions, safe harbors, self-certification, or some combination thereof. We recommend that to address these challenges in a way that is consistent with the statutory purpose and context of the monetization regime and the statutory domestic content requirements and their exceptions, Treasury should consider four goals when implementing the exceptions.

First, the guidance implementing the exceptions should attempt to provide a clear, workable process through which applicable entities can understand and claim the exceptions contained in the statute. Applicable entities constructing projects eligible for the generation credits will have varying capacities to navigate a domestic content exception process. Some applicable entities will have significant staff to devote to clean energy projects, while others, such as rural localities and small public power entities, will have only one or two employees overseeing such projects. The guidance will need to be sufficiently clear and detailed for entities with limited bandwidth to follow.

Second, the process should provide as much upfront certainty for applicable entities as possible about whether a relevant exception applies. The financing and viability of many projects will depend on the receipt of the generation credits. If applicable entities must wait until after they commence construction or file for the relevant credit to determine whether they qualify for a domestic content exception, they will not know if they will receive a credit at all until the IRS

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[184] *See, e.g.*, Rev. Proc. 2015-41, 2015-35 I.R.B. 263 (detailing procedures for advance pricing agreement requests).

[185] *See* IRS Announcement 2022-7, 2022-15 I.R.B. 946 (stating that the median time to complete a new unilateral APA and a new bilateral APA is 2 years and 4 years, respectively).

processes their tax return.[186] Such uncertainty could discourage applicable entities from taking up the intended tax incentives. For instance, public power entities might eschew owning their own projects and instead continue to use power purchase agreements with larger transaction costs and other drawbacks to secure clean energy.[187] Allowing applicable entities to determine their exception eligibility prior to commencing construction would give them the certainty they need to execute clean generation projects and access the intended subsidies.

Third, the guidance for domestic content exceptions should minimize the administrative burden of ensuring compliance with the statutory requirements for an exception for applicable entities, Treasury, and the IRS.

Fourth, consistent with the purpose of the underlying domestic content requirements, the system Treasury selects to administer the domestic content exceptions should curb opportunities for fraud and other deliberate non-compliance.

### 4.6.3 Options for Implementing the Domestic Content Exceptions

One way Treasury could implement the domestic content exceptions to attempt to meet these goals would be categorical exceptions for project types that meet the cost and nonavailability criteria. Each year Treasury could evaluate whether key defined generation project types could meet the domestic content requirements. If a type of project would be unable to meet the domestic content requirements because either relevant applicable project components were unavailable domestically or the incremental cost of complying with domestic content requirements would exceed 25 percent, Treasury would allow all projects of that type beginning construction that year to receive a domestic content exception. Importantly, Treasury would need to publicly justify the reasons for the exception, including listing out specifically which items were unavailable or drove up project costs. This would ensure that the administration of the statutory exceptions is used to provide the market and policymakers with information about what domestic supply gaps remain in ways that could support the statutory purposes of closing those gaps.

In publishing categories of projects eligible for an exception, Treasury will need to determine how broadly and granularly it specifies any category. This will depend, in part, on whether Treasury decides to issue nonavailability exceptions on an applicable project component basis or

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[186] This hypothetical assumes the applicable entity began construction on the project in 2026 or later, when non-compliance with the domestic content requirements results in losing 100 percent of the elective payment of the generation credits.

[187] *See, e.g.,* American Public Power Association, *How Public Power Could Benefit from a Direct-Pay Tax Credit* (January 24, 2022) ("The problem is that the transactional costs of [power purchase agreements] can be high, and only a portion of the value of the tax credit is generally considered to be passed on to the purchaser, thus muting the incentive."). Notably, taxable project owners with whom public power entities enter into power purchase agreements would not have to satisfy domestic content requirements to receive a generation credit because they would not be using elective pay. As a result, if public power entities enter into power purchase agreements, neither they nor the taxable project owner must comply with the domestic content requirements.

on a facility-level basis, and how Treasury determines the implications of an exception.[188] (This comment focuses on the need for categorical exceptions that apply to all projects within a project type and does not take a position on either of these questions.) Furthermore, the general expectation should be that over time, the breadth of project type exemptions narrows and the granularity with which project types are defined increases.[189]

A project category approach to exceptions would provide critical upfront certainty for applicable entities. An applicable entity would be able to look at the list of projects that received an exception for the year and be able to move ahead with a listed project without worrying about whether it would qualify for an exception.

A project category approach would also promote horizontal equity across projects, ensuring that similar projects receive the same treatment when nonavailability of items or costs prevent full compliance with the domestic content requirements. This may be advantageous as compared to a waiver system that would require each applicable entity constructing a certain type of project to apply for a domestic content waiver because certain applicable project components are unavailable domestically. Such a system could lead to unequal access for applicable entities for multiple reasons. For instance, smaller or less sophisticated developers may not have equal access to existing domestic supply of materials; such access would likely depend on a number of factors including location, market power, and resources. If the application process were onerous, less sophisticated project developers might not apply for a waiver at all and decide to forgo

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[188] We are aware of three main possibilities about what it means to have a nonavailability exception on an applicable project component basis. First, an exception due to nonavailability of a given applicable project component could mean that an applicable entity with a project subject to the exception still needs to comply with the domestic content requirements for the remaining applicable project components. Under this scenario, a nonavailability exception would mean that the applicable entity removes the relevant applicable project component from its domestic content analysis. If the exception were for a steel or iron item, all of the remaining steel or iron items would need to be domestically manufactured. If the exception were for a manufactured product component or subcomponent, 40 percent of the total costs of all the remaining manufactured products would need to be from domestically produced manufactured products. A second option would be that an exception due to nonavailability of manufactured products (steel or iron) would mean that an applicable entity constructing such project would not need to meet the domestic content requirements for manufactured products (steel or iron) but would still need to meet the requirements for steel or iron (manufactured products). Third, it could mean that the applicable entity does not need to comply with the domestic content requirements at all.

The potential implications of a facility-level nonavailability exception would be similar to options two and three above.

A cost exception could exempt all applicable entities with the relevant project type from complying with domestic content requirements altogether. Alternatively, it could mean that applicable entities must comply with domestic content requirements until the incremental costs of compliance reach 25 percent of the overall costs of construction.

Relative to requiring projects that have an exception to meet the domestic content requirements to the extent possible, exempting projects that have an exception from all domestic content requirements would provide more upfront certainty to applicable entities, reduce applicable entities' administrative burden, and require less work from IRS when auditing an applicable entity. However, exempting projects with an exception from all domestic content requirements would reduce the incentive for applicable entities to purchase domestic items.

[189] The section 45X advanced manufacturing production credit subsidizes the domestic production of certain items critical for clean energy projects and may help close domestic supply chain gaps over time.

building the project. Categorical exceptions would also reduce the possibility of administrators inconsistently applying exceptions across a likely high volume of applications.

The suggested project type approach would also minimize administrative burden both for applicable entities and for the IRS with minimal compliance drawbacks. It would eliminate the need for potentially thousands of applicable entities to undertake duplicative efforts to confirm eligibility for a domestic content exception and for the IRS to have to process those applications in the case of a waiver or PLR system or to conduct onerous audits on the back end. For example, in 2024, every applicable entity beginning construction on a given project type might want a nonavailability exception for certain key project components. Instead of each of these applicable entities needing to scour the country for the components to prove they are unavailable, Treasury could perform that analysis itself and determine whether a nonavailability exception is needed. Relative to a PLR or waiver system, the IRS would not need to undertake the significant work of responding individually to an exception request. Relative to a self-certification system, the project category system would minimize the amount of work the IRS would have to do on audit to verify compliance with the domestic content requirements and exceptions.

To adopt the project type approach to publishing exceptions, Treasury would need to determine which categories of projects to consider for a published exception and develop the market understanding necessary to evaluate and define project categories. While challenging, the statute effectively requires the IRS and Treasury to develop that understanding in order to enforce the domestic content provisions and its exceptions, and it would likely be a less burdensome undertaking than administering these exceptions on a project-by-project basis.

Treasury could draw from expertise inside and outside of the government. For example, Treasury could consider utilizing expertise in other agencies, such as at the Office of Management and Budget's Made In America Office, which reviews waivers for Buy America requirements, and the National Institute of Standards and Technology Manufacturing Extension Partnership, which has extensive experience in domestic supply chain scouting.[190] In addition, Treasury could publish requests for information periodically, asking applicable entities and other market participants to submit information about items that may be unavailable domestically and the marginal costs of domestic content compliance for projects. Treasury could also publish a tentative list of exceptions and request comments.[191] This could be done in consultation with other agencies, including the Departments of Energy and Commerce, who may have the existing expertise needed to develop lists of excepted products by facility type. This approach would give Treasury access to input from those on the ground while stopping short of requiring every applicable entity to gather and submit information. Finally, Treasury could consider drawing on the model of using advisory councils (such as the IRS Advisory Council and the IRS

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[190] *See* Infrastructure Investment and Jobs Act, Pub. L. No. 117-58, § 70923, 135 Stat. 429, 1305-06 (2021); NIST Manufacturing Extension Partnership, Supplier Scouting (last accessed August 11, 2023).

[191] The Build America Buy America Act in the Infrastructure Investment and Jobs Act requires agencies administering Buy America preferences to similarly post proposed waivers for public comment. *See* Infrastructure Investment and Jobs Act § 70914(c).

Commissioner's Art Advisory Panel) to get regular taxpayer and market insights on this and other issues relevant to IRA credit implementation.[192]

If Treasury were to use categorical exceptions by project type, they would still need to determine how to administer exceptions for less common projects. It would be a significant burden on Treasury to determine whether every single possible type of generation project should receive an exception. Where the number of projects of a particular type is small, it likely makes more sense for applicable entities to establish whether nonavailability of certain items or compliance costs prevent them from satisfying the domestic content requirements. For any project not covered by the categorical exceptions, Treasury could provide detailed safe harbor guidance for what steps the applicable entity needs to take to secure a domestic content exception. This could include, for example, soliciting bids for relevant items of both domestic and foreign origin and documenting the bids received (or lack thereof) and the relevant price and lead-time information. For applicable entities that employ contractors to construct a facility and certify domestic content compliance, Treasury could supply specific language that needs to be included in the contract for applicable entities to rely on the contractor's certification.

If Treasury adopted a safe harbor approach, applicable entities that take the prescribed steps and keep records of their efforts would claim an exception without applying for one. Then, if later audited within the statute of limitations period, such entities would present their books and records to the IRS to substantiate the exception (just as filers would with any item on their return).[193]

Many other questions about the domestic content exceptions remain. Treasury will need to determine how to evaluate whether an item produced domestically but backordered for a stretch of time is "not produced in the United States in sufficient and reasonably available quantities."[194] It may not be appropriate for an item backordered for 15 days to be deemed unavailable. However, if an item is backordered for several months and the item is necessary for applicable entities to move forward with their projects (meaning construction cannot proceed without the item), then that item could be considered functionally unavailable. Treasury will need to consider what factors determine whether a backordered item is deemed unavailable. More broadly, Treasury will need to provide clear definitions of when an item is "not produced in the United States in sufficient and reasonably available quantities or of a satisfactory quality."

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[192] Unlike the art advisory panel, this type of body would not provide advisory opinions on what exceptions should be granted, but instead serve as another avenue for collecting input from those familiar with the relevant markets and project development.

[193] Treasury could consider requiring any applicable entity that claims an exception, whether via a categorical exception or safe harbor, to check a box during pre-filing registration to indicate that they are claiming an exception. This would provide the IRS with useful information when prioritizing audits. In addition, Treasury could aggregate and publish this information to help provide clear market signals about domestic supply gaps.

[194] Sections 45(b)(10)(D)(i)(II) and 45Y(g)(12)(D)(i)(II).

Treasury should address these questions, and the many others not discussed here, in guidance as soon as possible.

## 4.7 Develop Strong Taxpayer Services in Consultation with Entities and Communities with the Greatest Barriers to Access

As discussed in Part 3.1, a central goal of section 6417 is to broaden access to climate-related tax incentives for key potential market participants, including entities who may not have previously accessed credits or had significant interactions with the federal income tax system. Achieving these purposes requires that these entities can understand and take the steps necessary to claim these provisions accurately. Otherwise, administrative barriers could deter entities from undertaking projects and claiming the credits due to lack of awareness or lack of capacity to understand and comply with procedures for claiming the credits accurately. Such entities may also be especially likely to attempt to claim credits in full compliance with the law but make honest mistakes that unnecessarily expose them to back-end compliance activity, including audit, or otherwise cause them to fail to qualify for credits they are rightly eligible for.

The Administration should therefore build on and expand efforts to provide information and assistance about accurately claiming the credits to potential eligible filers—with particular focus on categories of filers that are likely to face high administrative barriers to claiming IRA tax credits and are critical to the IRA's emissions reduction and equity goals. This includes filers who have previously filed tax returns but currently lack sophistication and access to high-quality tax advice to effectively navigate the credit regime (such as small for-profit entities and tax-exempt organizations). It also encompasses filers who will be making a tax filing for the first time to claim credits (such as governmental entities, territories, and tribal governments).

Such applicable entities will require clear information and customer service support to timely file returns and successfully claim credits. They may be especially likely to experience challenges and require assistance on topics such as:

- Eligibility to claim credits—including eligibility questions from applicable entities such as territorial governments.
- The applicable entity's correct tax year—especially for State and local governments that use a June 30 fiscal year but would benefit from using a calendar year for tax purposes.
- The pre-filing registration process—including what information will be required, and timing issues related to procuring a pre-filing registration number prior to filing a return.
- How to claim the credits on a return if the filing entity has never filed one before, including timing of filing and when to anticipate payment.
- How to comply with domestic content and wage and apprenticeship requirements and claim any relevant exceptions.
- What constitutes a tax partnership with another entity and how to elect out of subchapter K.

- How to navigate tenancy-in-common as an alternative to partnerships.

The Administration should prioritize meeting this demand with services targeted to entities most likely to experience challenges understanding and complying with IRA and tax system requirements.

We set out below why that will be necessary both to achieve the purposes of the IRA and for the IRS to deliver on other legal requirements and the Administration's commitments to reducing administrative burdens, furthering equity, and improving service. Meeting these goals will also require considering and using a range of outreach and assistance strategies.

### 4.7.1 The IRS Should Deliver on the Purposes of the IRA and Other Relevant Equity Requirements and Commitments when Developing Taxpayer Services

The IRA, as well as several other legal frameworks and administrative commitments, require the IRS to consider equity and access in its build-out of taxpayer assistance for IRA tax credits, especially with respect to underserved communities and filers likely to face barriers to accessing IRA provisions. We outline those frameworks and commitments below.

- **Purposes of the IRA**. Part 3.1 explains how access for new market participants is a key goal of the IRA and its monetization provisions, given the history and structure of the IRA. This includes, specifically, improving upon prior regimes where complexity, uncertainty, and administrative and transaction costs—rather than underlying eligibility rules—were barriers to tax incentive access.
- **Executive Order 13985 "Advancing Racial Equity and Support for Underserved Communities Through the Federal Government" and Executive Order 14091 "Further Advancing Racial Equity and Support for Underserved Communities Through the Federal Government."** EO 13985 directs federal agencies to assess "potential barriers that underserved communities and individuals may face to enrollment in and access to benefits and services in Federal programs."[195] EO 14091 states "Underserved communities often face significant barriers and legacy exclusions in engaging with agencies and providing input on Federal policies and programs that affect them. Agencies must increase engagement with underserved communities by identifying and applying innovative approaches to improve the quality, frequency, and accessibility of engagement." It also directs agencies to take proactive steps to ensure that underserved communities can access federal resources that support equitable economic opportunity.[196]
- **Executive Order 14008 "Tackling the Climate Crisis at Home and Abroad."** EO 14008 establishes the White House Environmental Justice Interagency Council ("Interagency Council") and tasked it with "develop[ing] a strategy to address current and historic environmental injustice by consulting with the White House Environmental Justice Advisory

[195] *See* Executive Order No. 13985, *supra* note 103, at 7010.

[196] *See* Executive Order No. 14091, *supra* note 106, at 10830.

Council and with local environmental justice leaders."[197] The Interagency Council will also "develop clear performance metrics to ensure accountability and publish an annual public performance scorecard on its implementation."[198] EO 14008 establishes the Justice40 Initiative to make historic investments in disadvantaged communities.[199] It also addresses key Administration priorities related to environmental justice and access for underserved communities, including "turning disadvantaged communities—historically marginalized and overburdened—into healthy, thriving communities, and undertaking robust actions to mitigate climate change while preparing for the impacts of climate change across rural, urban, and Tribal areas."[200]

- **Executive Order 14058 "Transforming Federal Customer Experience and Service Delivery to Rebuild Trust in Government."** EO 14058 states that "the Federal Government must design and deliver services in a manner that people of all abilities can navigate." It instructs agencies to "work with the Congress; the private sector and nonprofit organizations; State, local, Tribal, and territorial governments; and other partners to design experiences with the Federal Government that effectively reduce administrative burdens."[201]
- **Treasury Compliance Framework.** The first principle is to, "make it easier for individuals and entities who want to comply with the law to fulfill their obligations," including as follows:

  > Making program rules and guidance more accessible and making application, filing, payment and reporting processes more user-friendly will benefit people and organizations that seek to meet their obligations and intend to claim only the funding, incentives, credits, or benefits to which they are entitled. By helping people avoid errors on the front end—especially predictable or common mistakes that could be subject of enforcement activity—we will avoid unnecessary enforcement actions that are burdensome for both the government and stakeholders. [202]

- **SOP commitments to taxpayer service and emphasizing "front-end" compliance.** The SOP contains several commitments consistent with robust, proactive education and customer service support for the IRA credits, and especially for entities that are most likely to otherwise face barriers to access. [203] These include:
  - **Specific commitments to effective delivery of the clean energy provisions of the IRA.** The SOP commits to "dramatically improve" taxpayer services to help filers

[197] *See* Executive Order No. 14008, *supra* note 107, at 7620.

[198] *Id.*

[199] *Id* at 7631; *see also* White House, Justice40 A Whole-of-Government Initiative (2022).

[200] *See* Executive Order No. 14008, *supra* note 107, at 7629.

[201] *See* Executive Order No. 14058, Transforming Federal Customer Experience and Service Delivery to Rebuild Trust in Government, 86 Fed. Reg. 71357, 71357 (December 16, 2021).

[202] Memorandum, U.S. Dep't of Treasury, Principles for Promoting Fair and Effective Compliance (June 8, 2023).

[203] IRS, Inflation Reduction Act Strategic Operating Plan FY 2023-2031 2 (2023).

meet their obligations and claim credits they are eligible for.[204] In particular, the SOP acknowledges that improving customer service will further energy security and clean energy provisions of the IRA by raising filers' awareness of energy credits they may be eligible to claim and supporting them in doing so by optimizing delivery of education and assistance.[205]

Initiative 1.9 promises "education and assistance" to filers seeking to claim tax incentives like the IRA credits.[206]

- **Commitments to improve access to credits and adopt a customer-centric approach more generally.** Other more general commitments throughout the SOP should also apply to the new IRA credit regime.

  This includes a commitment in Initiative 1.9 to improve credit access generally, including to "[r]eview and revise policies and processes to make the process for taxpayers to claim credits . . . more efficient," to "[e]xpand the scale and scope of outreach and education forums," to "[e]nhance and cultivate community-based relationships and improve direct outreach," and to "[e]xpand partnerships with government agencies, private institutions, and others to provide education and service."[207]

  It also includes Initiative 1.12's commitments to developing "multichannel customer assistance" to ensure filers can access customer service effectively through the platform that works best for them in order to receive timely and efficient assistance.[208]

- **Focus on "upstream" compliance tools.** The SOP throughout emphasizes that efficient compliance requires focus on preventing or addressing potential non-compliance, rather than downstream audits or other enforcement activity. For example, Objective 2 is a commitment to quickly resolve taxpayer issues when they arise.[209] This includes Initiative 2.4, which addresses pre-filing programs designed to provide certainty to filers and help the IRS and filers navigate complex programs ahead of filing a return.[210] This focus on front-end tools and assistance is highly aligned with the structure of the energy tax provisions specifically, given their reliance on the novel monetization provisions which will involve a new pre-filing registration process.

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[204] *Id.* at 16.

[205] *Id.* at 17.

[206] *Id.* at 36.

[207] *Id.* at 36-37.

[208] *Id.* at 44.

[209] *Id.* at 46.

[210] *Id.* at 54-55.

- **Taxpayer Bill of Rights**. This includes the right to "be informed" through "clear explanations of the laws and IRS procedures" and the right to "quality service" through "prompt . . . and professional assistance."[211]
- **Building a Clean Energy Economy Guidebook.** Released in January 2023, this resource includes a section titled "The Inflation Reduction Act's Commitment to Equity, Environmental Justice, and Working Families in Clean Energy and Climate Programs." This section discusses key commitments to environmental justice and identifies specific populations targeted by the IRA, including Tribes. It notes that "Native communities have long suffered from underinvestment, contributing to poor health and economic outcomes" and makes a commitment to leverage IRA funding to invest in energy-related projects and Tribal climate resilience. [212]

### 4.7.2 The IRS Should Consider a Range of Strategies to Support Underserved Communities

Providing adequate support to underserved communities will require a range of strategies, including leveraging community partnerships, providing plain-language educational materials, and offering culturally appropriate and language-accessible education and customer service support. Here we offer both some approaches for selecting those strategies, and some specific strategies that could be considered.

**Broad approaches:**

- **Expand on efforts to proactively consult entities and communities with the greatest barriers to access in order to gain an understanding of the tools and information they require.** Many such entities and communities may currently lack awareness of the types of credits they may be eligible for and may not be able to proactively ask for the information and technical assistance that will better enable them to access these credits over time. Treasury and the IRS should build on current strategies such as convening roundtable discussions and seeking public input to identify the best way to reach and support these entities.[213] The Proposed Elective Pay and Transferability Regulations, and other pending regulations, can address areas of uncertainty to provide clarity and promote access.
- **Build on Treasury and the IRS's existing processes and knowledge of outreach and education methods that work and incorporate research, monitoring, and evaluation to**

[211] IRS, Taxpayer Bill of Rights (last accessed August 10, 2023).

[212] White House, Building a Clean Energy Economy: A Guidebook to the Inflation Reduction Act's Investments in Clean Energy and Climate Action 7-8 (January 2023).

[213] *See, e.g.*, Press Release, U.S. Dep't of Treasury, Treasury Department Convenes Roundtable Discussion on Inflation Reduction Act Incentives for Underserved Communities (April 27, 2023) (summarizing a series of roundtable discussions held by Treasury with 40 small climate businesses and tax-exempt developers on the Low-Income Communities Bonus Credit Program); *see also* Press Release, White House, Biden-Harris Administration Launches Public Process to Inform Development of Environmental Justice Scorecard, First-ever tool to Assess Government-Wide Progress on Environmental Justice (August 3, 2022) (outlining the White House's announcement "seeking public input on the Environmental Justice Scorecard").

**strengthen and expand successful strategies**. The IRS can learn from and build on outreach and access efforts inside and outside of tax and leverage relationships that other agencies may have with specific entity types. Ongoing assessment—both quantitative and qualitative—should also be integrated into outreach and assistance efforts to measure progress and efficacy.

- **Reserve sufficient budget resources for outreach and assistance efforts.** Even as the IRS considers and select specific outreach and assistance strategies for States, localities, territories, tribal governments and other key potential filers and stakeholders, the Administration should reserve adequate resources for targeted assistance of this type, and should ensure resources are available early on to address filers' front-end educational and informational needs.
- **Focus on providing information and assistance for navigating the pre-filing registration process.** This is the key compliance mechanism created by the IRA and is also a novel tax compliance approach. If this pre-filing registration process is streamlined and well-supported, it could help the IRS and filers avoid errors and other compliance problems. The IRS should aim for this process to be easy for unsophisticated users to navigate, ask only for necessary information that applicable entities will have readily available, and ensure the pre-filing registration system is well-supported through the provision of multichannel customer service support.

**Illustrative examples of specific strategies for delivering service and compliance that the IRS can consider include:**

- **Outreach and educational materials.** The IRS should build on existing helpful educational tools, such as the Elective Pay and Transferability Frequently Asked Questions ("FAQs") to expand the availability of educational resources that are geared towards a less sophisticated audience, as well as materials targeted to specific entity and project types.[214] These could include additional fact sheets and manual(s) addressing the pre-filing and filing process and other anticipated processes including seeking a domestic content waiver, and materials covering specific processes or questions targeted to particular entities. These materials should be in simple language appropriate for a less sophisticated filer without access to tax experts and should be translated into common languages to ensure the information is accessible to a diversity of potential project participants. Treasury and the IRS can also continue to use multiple channels— including print, in person, webinars, recorded instructional videos, and other interactive training tools—to distribute materials.
- **Streamlined methods for finding and connecting with relevant information and services.** The IRS should consider a variety of methods to make it easy for different filer types with specific compliance and eligibility needs to connect with the resources that are most relevant for them. Such approaches could include setting up specific service contacts for particular stakeholder types (such as governmental entities) and ensuring that online and

[214] IRS, Elective Pay and Transferability FAQs, *supra* note 98.

phone resources can quickly direct filers to the targeted information that is most relevant to them. For example, the IRS could develop a one-stop customer assistance portal similar to the Centers for Medicare and Medicaid Services' Registration for Technical Assistance Portal, with resources customized for various types of entities that might benefit from the credits. Over time, such a portal should also provide ways for filers to reach service representatives to receive help with questions.

- **Ongoing Stakeholder Outreach and Partnerships**. The IRS has expertise in developing stakeholder partnerships for outreach efforts, including within the Stakeholder Partnerships, Education and Communication arm in areas including EITC and CTC outreach. It can adopt and refine a range of approaches used in these areas, including developing outreach and training materials for use by high-capacity partners, summits, and establishing advisory bodies. Treasury and other agencies may consider engagement with philanthropy in order to help improve targeting of education, outreach, and technical assistance resources. The IRS should also consider establishing a centralized implementation office to improve the coordination of operations and messaging.
- **Improve outreach through data collection and transparency**. The IRS should share regular, anonymized updates on the status of project development and credit delivery at the most granular level possible to ensure appropriate confidentiality. This data would help groups target outreach efforts to areas that may be struggling to identify potential projects or comply with tax credit guidance.

# 5 Comments on Transferability

## 5.1 Reconsider Statutory Authority for Not Applying Passive Activity Limitations to Credit Transferees, Consider Interactions with Other Regulatory Decisions When Determining Whether to Use This Authority, and Revisit as Necessary

We turn now to the Proposed Transferability Regulations' application of the passive activity provisions of section 469 in the context of credits transferred pursuant to section 6418. The preamble and Proposed Transferability Regulations provide that a credit transferee described in section 469(a)(2) (i.e., a credit transferee that is an individual, estate, trust, closely held corporation, or personal service corporation) is treated as engaging in the underlying trade or business but as not materially participating in such trade or business. The result is that, under the proposed regulations, credits purchased by these transferees will be treated as passive activity credits and disallowed if the transferee does not otherwise have sufficient tax liability allocable to passive activities for the year.

Our analysis below concludes that although the approach of the Proposed Transferability Regulations is within Treasury's authority, it would also be within Treasury's authority to treat the credit transferee as not engaged in a trade or business as a result of the transferee's purchase and claim of the credits and therefore not limited under section 469. We set out some of the purposes of section 6418 and section 469 that Treasury should consider when determining which of these available approaches to adopt, but we find that these considerations do not uniformly favor one approach over the other.

The most important consequence of treating credit transferees as not limited by section 469 is that it would permit individuals to be credit purchasers. We see the fundamental trade-off as follows: allowing individuals to be credit purchasers would potentially allow for thicker markets, providing more tax capacity for the credits to be absorbed and reducing spreads. However, allowing individuals to be credit purchases also raises important concerns including potential concerns about fraud and abuse since individuals, particularly those who are less affluent, may have less ability to perform due diligence on the credits and may become targets of fraudulent schemes.

As discussed in Part 3.1.2, this issue cannot be evaluated in a vacuum. It is interconnected with regulatory approaches taken in other areas (including the approach to elective pay through partnerships, transferee elective pay, and other regulatory options). The overall set of rules adopted must be considered and monitored on a holistic basis to ensure that the relevant markets are functioning properly. In addition, the risk of fraud depends on the approach taken to the pre-filing registration system. If the pre-filing registration system is enhanced in ways that increase certainty that credits are properly determined and reduce the risk of consumer fraud, this would weigh in favor of permitting individuals to purchase credits.

That is, the option of permitting individuals to purchase credits will be more attractive given the purposes of the IRA if Treasury does not exercise other authorities to improve access to tax credits and thicken transfer markets in ways that improve their efficiency. It will also be more attractive if Treasury robustly implements the pre-filing registration system and includes plans for building on that system over time. Further, Treasury should actively monitor the transfer markets and re-evaluate them as time goes on to ensure that tax capacity does not become an improper bottleneck to the IRA's deployment goals.

### 5.1.1 The Proposed Regulations Are Within Treasury's Authority, but Treasury Has Authority to Take a Different Approach

Enacted in 1986, the passive activity provisions were intended to limit the use of syndicated tax shelters that were widely marketed at that time. Rather than attacking the tax shelters directly, the passive activity rules took what might be termed a "schedule" or "silo" approach, restricting the tax shelter deductions from being used to offset income from other sources, such as salaries or income and gain from stocks and bonds. Although tax credits were not a primary focus of the passive activity rules, section 469 limits their use. Reflecting the statutory purpose, section 469

applies to individuals and closely held corporations, but not to public companies (more technically, these rules are applicable to persons described in section 469(a)(2)).

Broadly speaking, section 469 restricts the use of deductions and credits from a trade or business activity unless the filer materially participates in the activity.[215] Deductions from passive activities are generally limited to the filer's income from passive activities with a carryover of restricted deductions to future years and unlimited use of restricted deductions when the filer disposes of the filer's entire interest in the activity.[216] Credits are subject to generally analogous limitations except that credits, unlike deductions, do not free up upon disposition.[217] The term "trade or business" includes any activity with respect to which expenses are allowable as a deduction under section 212.[218]

The threshold question is whether to apply section 469 at the transferor level or the transferee level. The Proposed Transferability Regulations take the view that section 469 does not apply at the transferor level, i.e., that it is irrelevant to the credit transferee's use of the transferred credits whether the transferor is subject to the limitations set forth in section 469. The preamble states that "[c]onsistent with applying credit utilization rules to transferee taxpayers, the proposed regulations would provide a rule that a transferred specified credit portion is treated as earned in connection with the conduct of a trade or business, and, if applicable, such transferred specified credit portion is subject to the passive activity limitation rules in section 469."[219] However, the preamble and Proposed Transferability Regulations also provide that a credit transferee subject to section 469 is treated as engaging in the underlying trade or business but as not materially participating in such trade or business.[220] As a result, a credit transferee subject to section 469 must treat the transferred credit as a passive activity credit, usable only to the extent of the credit transferee's passive tax liability.[221]

This is not the only reasonable approach under the statute. In fact, a different result does not require revisiting the approach to credit determination rules being applied at the transferor level and credit utilization rules being applied at the transferee level. The approach in the Proposed Transferability Regulations is that the transferor's actions which result in the credit being determined in a trade or business are imputed to the transferee, but the transferor's participation in the credit-generating activity is not similarly imputed. The preamble describes policy justifications including that, without this rule, "eligible credits earned and used by eligible taxpayers would be subject to different limitations than transferred eligible credits used by

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[215] *See* section 469(a)-(c).

[216] *See* section 469(a), (b), (d)(1), and (g).

[217] *See* section 469(a), (b), (d)(2), and (g).

[218] Section 469(c)(6).

[219] Section 6418 Transfer of Certain Credits, 88 Fed. Reg. at 40503.

[220] *Id.*

[221] In theory, a person that materially participates in the underlying activity could be a credit transferee and therefore satisfy the "material participation" requirement, but this would be a highly uncommon situation.

transferee taxpayers."[222] This is a reasonable rationale, but it does not demonstrate that the result is compelled by section 6418.

An alternative approach would not impute any trade or business to the transferee, such that the passive activity rules do not constrain the transferee. This alternative approach should not create risk of broad erosion to the passive activity rules because it relies on an interpretation of what it means for the transferee to be "treated as the taxpayer for purposes of" Title 26, which is language only found in sections 6418 and 45J(e). Nor does it disrupt the more general approach in the Proposed Transferability Regulations (as described in the preamble) to apply credit determination rules at the transferor level and credit utilization rules at the transferee level.

There is precedent under the New Markets Tax Credit (NMTC) for treating a filer who claims a credit without materially participating in the relevant trade or business as not conducting a trade or business. In Revenue Ruling 2010-16, the IRS examined whether investments in Community Development Entities ("CDEs") constituted a trade or business activity for the purpose of applying section 469, and if so, whether the filer would be treated as materially participating in the business of the CDE. The IRS ruled that such investments are not made in connection with the conduct of a trade or business, and thus the passive activity limitation does not apply to filers claiming the New Markets Tax Credit.[223] Although the NMTC credit is based on an investment in an entity rather than an investment in specific property or production, the ruling supports the proposition that merely claiming a credit does not put a filer in a trade or business for section 469 purposes.

### 5.1.2 Implications of the Purposes of the IRA Monetization Provisions and Passive Activity Loss Rules

The structure and purposes of both the passive activity loss rules and the IRA monetization provisions bear in complicated ways on the question of which approach Treasury should take.

Ensuring compliance and minimizing fraud are key elements of the IRA's monetization provisions and of tax administration more broadly. The alternative approach laid out above would allow individual retail investors to purchase and claim transferable credits, possibly allowing unscrupulous syndicators or fraudsters to defraud these investors (and the public fisc) with bogus transactions. This concern is important, though we note that even if the proposed regulations stand there will be a risk that unscrupulous actors may seek to defraud individual investors by selling them excessive tax credits without the investor realizing that the passive activity rules limit the credits' use.

[222] Section 6418 Transfer of Certain Credits, 88 Fed. Reg. at 40503.

[223] *See* Rev. Rul. 2010-16, 2010-26 I.R.B 769 (noting that there are two requirements for an activity to constitute a trade or business: "the activity must be conducted for income or profit, and the activity must be engaged in with some regularity and continuity." The act of purchasing tax credits likely would not occur with the requisite frequency and continuity to constitute a trade or business) (citing *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987)).

Many individual investors may also be less able to perform a strong due diligence function than corporate transferees. Therefore, allowing individuals to purchase credits more broadly may bring less market-based tax compliance benefits than if buyers are primarily corporations. This risk can be mitigated, at least somewhat, with an effective pre-filing registration regime.

However, expanding access and promoting the efficiency of transfer credit markets are also important goals of the IRA. A more robust market of buyers will likely translate into narrower spreads and therefore a larger proportion of the credit amounts going into projects. The thicker markets become, the more likely it is that developers of smaller projects and projects in disadvantaged communities will also be able to monetize tax credits and execute their projects.

As noted above, we recommend that Treasury think holistically about its approach both to compliance and to the risk that tax capacity could become a deployment barrier during the long-term life of these credits and consider the best ways to address this potential bottleneck. There are other options, including transferee elective pay and the ability to access elective pay through partnership structures, that could improve tax credit capacity in the system. The extent to which Treasury adopts those options, and the extent to which it builds out a robust pre-filing registration system, will be important for determining how to weight access and compliance considerations when considering how to apply the passive activity loss rules to transferees. The purposes of the passive activity loss regime are also important to consider, but do not point squarely in the direction of the approach in the Proposed Transferability Regulations.

One way of understanding the purposes of the passive activity rules is to focus on their role in limiting tax shelters. Prior to the passive activity rules, certain high-income filers had incentives to "invest" in wasteful ventures that produced economic losses because they generated tax savings that were even more valuable for filers.[224] This is why the tax shelters "involved a wide variety of products hardly crucial to the national economy, including such things as jojoba beans and chinchilla farms."[225] With this background in mind, lawmakers enacted section 469 in order to limit the use of tax shelters of the type that generated tax benefits for filers out of loss-making activities that lawmakers considered unproductive and undesirable.[226] Credit transfers pursuant to section 6418 are not a tax shelter-type activity; to the contrary, lawmakers are intending to encourage the underlying economic activities that the law targets, including clean energy development, by creating a robust market for the purchase and sale of IRA credits. Under this understanding of the purposes of section 469, there is no tension between the goals of the two statutory regimes, and the purposes of section 469 do not compel or even indicate that the

[224] *See* J. Comm. on Tax'n, General Explanation of the Tax Reform Act of 1986 209-10 (1987) ("General Explanation").

[225] Michael J. Graetz, *Tax Reform 1986: A Silver Anniversary, Not a Jubilee*, Tax Notes Federal (October 17, 2011).

[226] *See* J. Comm. on Tax'n, *supra* note 224 at 209-14 ("Extensive shelter activity contributes to public concerns that the tax system is unfair, and to the belief that tax is paid only by the naive and the unsophisticated. This, in turn, not only undermines compliance, but encourages further expansion of the tax shelter market, in many cases diverting investment capital from productive activities to those principally or exclusively serving tax avoidance goals.").

approach in the Proposed Transferability Regulations should be preferred to the alternative approach that we set out here.

Even a narrower understanding of the purposes of section 469 does not compel the approach in the Proposed Transferability Regulations. If the purpose of section 469 is more narrowly understood to be to turn off access to beneficial tax attributes from a trade or business activity unless the filer materially participates in the activity, then this sets up a direct tension with key purposes of section 6418, and it is not clear that section 469 purposes should override those of section 6418. The transfer market provisions of the IRA were enacted specifically to facilitate the development of a market to enable clean energy developers to monetize tax credits they could not use themselves by selling them to other market players. Given this tension (under this narrow understanding of section 469), no interpretive approach will be particularly elegant since nay approach will reflect two statutory regimes with different purposes where lawmakers did not explicitly address the possible interactions. Section 6418 does not explicitly address the application of passive activity rules and given the accelerated timeframe during which significant changes were made—including the transition from universal elective pay to two separate monetization regimes—determining legislative intent is very difficult.

Under either approach to understanding section 469's purposes, the objectives underlying section 469 do not, on their own, justify constraint of the use of section 6418. Furthermore, the alternative interpretive approach laid out here, which would not impute the transferor's conduct of a trade or business to the transferee, should not have general implications for the interpretation or application of the passive activity loss rules (and, specifically, the determination of a trade or business) because the approach is tied to the unique statutory structure and intent of section 6418.

In sum, the most important consequence of treating credit transferees as not limited by section 469 is that it would permit individuals to offset active income with purchased credits. We see the fundamental trade-off as follows: allowing individuals to broadly participate as credit purchasers would potentially allow for thicker markets, providing more tax capacity for the credits to be absorbed and reducing spreads. However, it also raises important concerns including potential concerns about fraud and abuse, as individuals, particularly those who are less affluent, may have less ability to perform due diligence on the credits and may become targets of fraudulent schemes.

This issue cannot be evaluated in a vacuum. It is interconnected with regulatory approaches taken in other areas (including the approach to elective pay through partnerships, transferee elective pay, and other regulatory options). We encourage Treasury to think holistically about its approach both to compliance and to the risk that tax capacity could become a deployment barrier during the long-term life of these credits, and what the best ways are to address this potential bottleneck. Changes to the application of passive activity rules represent one potential tool.

## 5.2 Improve Access to Investment Tax Credits in the Territories for Businesses

As discussed in Part 4.1 of this comment, the Proposed Elective Pay Regulations add territory governments to the list of applicable entities, but do not allow applicable entities in the territories to access elective pay on ITCs due to the limitations set forth in section 50(b)(1). We recommend in Part 4.1 that Treasury provide appropriate exceptions to section 50(b)(1), giving access to ITCs for projects predominantly used in territories when an elective pay election is made, or at a minimum, allow territory governments to do so. Though this modification would not ensure full access and parity for the territories, it would at least provide access to ITCs to territory governments.

Relatedly, we recommend here that Treasury address a similar access constraint in the Proposed Transferability Regulations: businesses in the territories are wholly excluded from the credit transfer markets with respect to the ITCs under sections 48 and 48E, including credits needed to build out grid resiliency and distributed generation such as energy storage and micro-grids, the clean vehicle and charging credits under sections 45W and 30C, and the advanced manufacturing credit under section 48C, while businesses in the States have full access. Further, unless they partner with a state-based corporation, territory businesses are not eligible for the low-income communities bonus credit program. This is because section 6418 is silent with respect to the limitation set forth in section 50(b)(1), meaning that filers in the territories are generally not eligible to determine these credits in cases where the underlying credit property is predominantly used outside the States and DC.

To provide improved access to IRA credits for filers in the territories, we recommend that Treasury exercise its authority under section 6418 to provide an exception to section 50(b)(1) with respect to filers using 48, 48E, 30C, and 45W credit property predominantly in the territories, to the extent that these filers make a section 6418 election. As described in Part 4.1 of this comment, the IRA gives broad authority to the Secretary under section 6418 and other relevant sections, and that authority can be used to provide exceptions to section 50(b)(1) in the regulations in appropriate circumstances. Section 6418(h) provides that "[t]he Secretary shall issue such regulations or other guidance as may be necessary **to carry out the purposes of this section.**"[227] The various other grants of authority contained in the key credit provisions that are subject to section 50 rules, as described in Part 4.1.2 of this comment, are similarly permissive.[228] Pursuant to this authority, we recommend Treasury modify the Proposed Transferability Regulations.

This recommendation is consistent with Treasury's appropriate use of regulatory authority contained in the IRA in other contexts, to ensure appropriate treatment of IRA tax credits, even

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[227] Section 6418(h) (emphasis added).

[228] As explained in Part 4.1.2, sections 45W and 48 instruct the Secretary to issue "guidance as the Secretary determines necessary to carry out the purposes of this section;" section 30C(h) instructs the Secretary to "prescribe such regulations as necessary to carry out the provisions of this section;" and section 48E(i) instructs the Secretary to "issue guidance regarding implementation of this section" (although section 48E(i) also includes a deadline).

when the statute is silent. First, Treasury, in the Proposed Elective Pay Regulations, has already added US territories to the list of applicable entities, specifically as "organizations" exempt from tax, notwithstanding that territories are exempt from tax under section 115 (in a manner similar to States) rather than section 501 and other sections governing tax-exempt organizations. Another example involves the intersection of the Corporate Alternative Minimum Tax and transferability under section 6418. Under section 56A, AFSI shall, in general, "be appropriately adjusted to disregard any amount treated as a payment against the tax imposed by subtitle A pursuant to an election under section 48D(d) or 6417."[229] The statute is silent on adjusting AFSI when an election is made under 6418. Despite the statutory silence on the treatment of consideration received for credits transferred under section 6418, Treasury has determined that it is generally appropriate to disregard these amounts in determining AFSI.[230]

We recognize that Treasury may have reasonable concerns about potential abuse and fraud on the part of filers claiming and transferring credits, but we think that other tools in the statute are the most appropriate ways to address these concerns. Compliance concerns may be particularly acute for ITCs claimed and transferred in the territories given the fact that (1) total facility costs are driving the credit amount and the amount sold into the credit markets, and (2) the IRS may have less oversight of these filers as compared to filers in the States. However, Treasury is establishing a novel and robust pre-filing registration process in the Proposed Transferability Regulations that can be leveraged to allow the IRS to prevent duplication, fraud, improper payments, and excessive transfers of credits. Eligible filers must submit, among other things, supporting documentation containing the addresses and coordinates of credit property, beginning of construction date, and placed in service date in order to receive a registration number for each credit property.[231] This process ensures that filers seeking to transfer credits for ITC property in the territories will be subject to much the same scrutiny as filers transferring credits in the US. This should largely mitigate any concern for potential misconduct in the territories. As also noted in Part 4.1.2, the IRS can choose to use implementation funding provided by the IRA to further ensure appropriate oversight in all relevant geographic areas. Current compliance gaps should be addressed, rather than remaining a barrier to access.

We further recognize that, pursuant to the exception to section 50(b)(1), ITCs may be available if the property is owned by a domestic corporation. However, requiring projects—especially small projects—to establish a corporation in a State in order to claim a transferrable credit adds administrative burden without any compliance benefit, especially if the corporation lacks tax liability and is simply selling the credit under section 6418. Therefore, such self-help introduces unnecessary barriers to IRA credit access for projects in the territories. As discussed above, simply denying access to monetization methods authorized by statute for certain market

[229] Section 56A(c)(9).

[230] *See* Notice 2023-7, 2023-3 I.R.B. 390, section 6.02(2).

[231] *See* Prop. Treas. Reg. § 1.6418-4(b)(5).

participants or projects should be the last resort rather than the first tool that the Administration uses to address compliance risks.

For these reasons, we recommend Treasury modify the Proposed Transferability Regulations accordingly so that section 50(b)(1) does not apply to filers transferring credits arising from credit property predominantly used in the territories.