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Nov. 4, 2022

VIA ELECTRONIC SUBMISSION [www.regulations.gov]

Internal Revenue Service
CC:PA:LPD:PR (Notice 2022-50)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20224

Re: Comments re IRS Notice 2022-50 (Request for Comments on Elective Payment of Applicable Credits and Transfer of Certain Credits)

To Whom it May Concern:

Nareit appreciates the opportunity to respond to IRS Notice 2022-50 (Oct. 5, 2022) (Notice 2022-50), which requests general and certain specific comments on questions arising under new sections 6417 and 6418[1], as recently enacted in "An Act to Provide for Reconciliation Pursuant to Title II of S. Con. Res. 14" (Pub. L. No. 117-169) (otherwise known as the Inflation Reduction Act, or the IRA).

Nareit® serves as the worldwide representative voice for real estate investment trusts (REITs)[2] and real estate companies with an interest in U.S. real estate. Nareit recognizes the importance of practicing environmental stewardship and sustainability, as well as the importance of affirmatively addressing climate risk. Many REITs have long records of documented leadership roles on sustainability matters.[3] REITs are in the forefront of promoting sustainable building models and technology. Today, nearly 2,700 REIT-owned buildings (covering approximately 712 million square feet) have been LEED or Energy Star certified, or have qualified under other commercial real estate "green" rating programs.[4] REIT-owned

[1] Unless otherwise provided, any reference to a "section" herein shall be to the Internal Revenue Code of 1986, as amended (the Code).
[2] Nareit's members are REITs and other real estate companies throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses. REITs of all types collectively own more than $4.5 trillion in gross assets across the U.S., with stock-exchange listed REITs owning over $3 trillion in assets. U.S. listed REITs have an equity market capitalization of more than $1.4 trillion. REITs provide everyday Americans the opportunity to invest in real estate, and 145 million Americans live in households that benefit from ownership of REITs through stocks, 401(k) plans, pension plans, and other investment funds.
[3] *See* Nareit Leader in the Light Awards available at https://www.reit.com/nareit/industry-awards/leader-light-award.
[4] *See* Nareit, REIT ESG Dashboard, supra note 6; other green certifications include Energy Star and BREEAM USA.

1875 I Street, NW, Ste 500
Washington, D.C. 20006-5413
202-739-9400

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properties are often at the forefront of sustainable building innovations.[5] Nareit estimates that U.S. REITs own approximately 3.5 billion square feet of roof space that may be available for solar generation.[6]

Executive Summary

This comment letter focuses on issues arising for REITs under section 6418, which permits certain tax credits to be transferred from an eligible taxpayer to an unrelated taxpayer. These are priority issues that would directly impact the ability of REITs to make investments in several clean energy projects that would be eligible for the modified or newly enacted tax credits under the IRA (such as rooftop solar panels and electric vehicle charging stations). Congress clearly expected REITs to be able to use the new energy credits to provide significant climate benefits,[7] so it is vital that the Treasury Department resolve these technical questions to further Congressional intent.

In particular, Nareit requests that the IRS confirm that: a) the mere entitlement to a transferable tax credit (either directly or indirectly through a partnership or limited liability company) does not give rise to gross income; b) the ownership of a transferable energy tax credit is a qualifying real estate asset under section 856(c)(5)(B); c) the transfer of an energy tax credit pursuant to section 6418 and the transfer of energy pursuant to the rules of sections 45 and 45Y are not dealer sales for purposes of the prohibited transactions tax rules of section 857; and, d) as more fully described in the Oct. 28, 2022 letter by nine real estate trade associations including Nareit, a partnership can elect both the direct pay option under section 6417 for its tax-exempt partners and the transferability option under section 6418 for its taxable partners. In addition, Nareit requests that the IRS prescribe how and when to make the section 6418 election.

[5] *See*, *e.g.*, Salesforce Tower in San Francisco, which is owned by Boston Properties, a publicly traded REIT, is LEED Platinum certified and won first place in the Sustainable Building category for the 2018 International Edition of the CEMEX Building Awards. See, https://www.businesswire.com/news/home/20181023005277/en/Boston-Properties-Earns-Top-ESG-Rating-and-Executes-Sustainable-Development-Strategy-at-Salesforce-Tower; and the Empire State Building, owned by a publicly traded REIT, Empire State Realty Trust, which is the largest commercial real estate user of fully renewable energy and was awarded the highest awards for sustainability performance by GRESB and Green Star in 2021. See, Sarah Kaplan, The Washington Post, Climate Solutions, The Empire State Building and its Related Buildings are Now Powered by Wind (Feb. 3, 2021) available at https://www.washingtonpost.com/climate-solutions/2021/02/03/climate-empire-state-wind/ and PR Newswire, The Empire State Building to Celebrate 90 Years (Apr. 29, 2021) available at https://www.prnewswire.com/news-releases/the-empire-state-building-to-celebrate-90-years-301280789.html.

[6] Nareit analysis of S&P Global and individual REIT data; *see* https://www.reit.com/news/blog/market-commentary/reit-solar-opportunities-35-billion-square-feet-roof-space.

[7] *See* section 6418(c), added by the IRA (modifying the prior law limits in section 50(d) applicable to REITs); *see also* https://www.congress.gov/117/crec/2022/08/06/168/133/CREC-2022-08-06.pdf (at p. S4166).

Discussion

A. Background: REITs

1. REITs generally

Authorized by Congress over 60 years ago, and based on the model for mutual funds, REITs are vehicles through which investors can invest in professionally managed portfolios of income-producing real estate assets.

Like a mutual fund, a REIT is not subject to entity-level federal income tax on taxable income that it distributes to its shareholders as dividends each year. However, to achieve this tax treatment, sections 856 through 860 require a REIT to satisfy several tests related to the nature of the REIT's assets, the sources of its income, its mandatory distributions to its shareholders, and the ownership of its stock. Although REIT income in general is not subject to a corporate-level tax and is subject to tax at the investor level similar to partnerships and other types of fiscally transparent entities, the REIT income and asset tests, coupled with the mandatory distribution rules, and the fact that REITs may not pass through losses and tax credits (including energy tax credits) to investors, distinguish REITs from these other types of entities that are taxed only at the investor level.

2. REIT gross income and asset tests and the 90% distribution requirement

a. Gross income tests

To ensure that a REIT derives substantially all of its income from real estate related sources, a REIT is required to derive at least 75% of its gross income each year from real estate related sources like rents from real property and interest on mortgages on real property (75% Gross Income Test)[8], and 95% of its annual gross income from those sources as well as other types of passive income like bank deposit interest (95% Gross Income Test).[9]

[8] I.R.C. § 856(c)(3).

[9] I.R.C. § 856(c)(2).

b. Asset tests

Among other things, on a quarterly basis, at least 75% of the value of a REIT's total assets quarterly must be from "real estate" sources (including foreign real estate), cash and cash items (including receivables), and government securities (75% Asset Test)[10].

c. Distribution test

A REIT also must distribute 90% of its REIT taxable income each year (the 90% Distribution Requirement).[11] Like a mutual fund, a REIT is allowed a dividends paid deduction in computing its taxable income.[12]

3. REIT prohibited transaction tax

REITs are subject to an excise tax of 100% of the net income derived from a prohibited transaction (colloquially known as a dealer sale), which is defined as the sale or other disposition of property by the REIT that is not foreclosure property and is ''stock in trade of a taxpayer or other property which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held for sale to customers by the taxpayer in the ordinary course of a trade or business."[13]

Whether property is held "primarily for sale to customers in the ordinary course of a trade or business" depends on the particular facts and circumstances. However, an exception applies if the REIT satisfies certain safe harbor requirements in sections 857(b)(6)(C) (with respect to property held for the production of rental income) or (D) (with respect to certain property held in connection with timber production), including: 1) an asset holding period of at least two years; and, 2) either a) seven or fewer sales of property in the year of sale or b) generally speaking, sales of less than 10% of its properties (based on aggregate adjusted tax basis or fair market value) that year or less than 20% of its properties for the year of the sale and less than an average of 10% when measured for the year of the sale and the preceding two years.).

[10] I.R.C. § 856(c)(4).

[11] I.R.C. § 857(a)(1)(A).

[12] I.R.C. § 857(b)(2)(B).

[13] This definition is the same as the definition of certain property the sale or other disposition of which would produce ordinary income rather than capital gain under § 1221(a)(1), determined without regard to whether or not such property qualifies for the safe harbor from the prohibited transactions rules.

B. Notice 2022-50: Tax Credit Transferability Issues

1. Gross income exclusion

a. General rules

Under section 6418(b)(2), the amount received by a taxpayer for the transfer of an eligible tax credit is not included in the gross income of the taxpayer transferring the tax credit ("gross income exclusion"), and under section 6418(b)(3), the amount paid by a taxpayer for the receipt of an eligible tax credit is not deductible by the taxpayer. In addition, section 6418(c)(1) provides that any amount received by a partnership or S corporation for the transfer of an eligible tax credit is treated as tax-exempt income for purposes of section 705 (determination of basis of a partner's interest in a partnership) and section 1366 (rules for pass-thru of S corporation items to shareholders), and that a partner's distributive share of such tax-exempt income is based on the partner's distributive share of the transferred credit. Section 6418(c)(2) provides that the election to transfer eligible tax credits is made by the partnership or S corporation, not the partners or shareholders.

b. Receipt (or right to receive) transferable tax credits

Sections 6418(b)(2) and (c)(2) are clear that proceeds from transferring energy tax credits are not includible in gross income of the transferor. However, the IRA does not specifically address the tax consequences of the entitlement to transferable tax credits, *e.g.,* a taxpayer's entitlement to such a credit after making the requisite expenditures and meeting the other requirements for eligibility for such a credit or as a result of a merger/acquisition by one taxpayer with another taxpayer that is entitled to such a credit. In the context of transferable **state** tax credits, the IRS held in PLRs 202005017 and 202005018 that amounts included in income by a REIT in accordance with section 451 from the **receipt** of such tax credits was qualifying income under the 95% and 75% income tests of Section 856(c)(2) and (3).

Because tax credits generally do not give rise to gross income to the taxpayer that earns the credits, presumably section 6418(b)(2) does not change this result simply because the credits are transferable, while section 6418(b)(3) preserves symmetry by providing that payments for transferable credits are not deductible. Treating transferable tax credits as gross income prior to transfer when earned by the taxpayer would upend this symmetry, particularly when proceeds from transferring a tax credit will be some amount less than the reduction in taxes from claiming the credits.

Therefore, Nareit recommends confirmation that the receipt of (or right to receive) a transferable **federal** tax credit does not result in income, either because the gross income exclusion applies to both the

receipt of the tax credit as well as the amount received from transferring a credit, or because the gross income exclusion does not implicitly override, for transferable tax credits, the general treatment of tax credits as not giving rise to income when the taxpayer earns the tax credits prior to transfer.

2. Sales of energy tax credits/produced energy and the prohibited transactions tax

a. Confirm transfers of energy tax credits are not dealer sales under the REIT prohibited transaction tax rules

The legislative history of the prohibited transaction tax indicates that Congress enacted it to deter REITs from engaging in "ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project."[14] Moreover, Congress believed that "REITs should have a safe harbor within which they can modify the portfolio of their assets without the possibility that a tax would be imposed equal to the entire amount of the appreciation in those assets"[15]. For that reason, as also described above in section A.3., section 857(b)(6)(C) and (D) allow a REIT to sell a modest amount of real property and still qualify for the prohibited transactions tax safe harbor if certain conditions are met – including that the REIT make no more than seven "sales of property"[16] or its "property sold"[17] that year or over a three- year period does not exceed a certain percentage of its total properties.

However, the Code does not specifically define "sales of property" or "property sold" for purposes of the safe harbor. As a result, taxpayers have sought guidance from the IRS regarding this definition. For example, the IRS has relied upon the legislative history cited above to conclude that the section 1031 like-kind exchange transactions in which no gain was recognized are not considered "sales of property" under the prohibited transactions safe harbor). *See, e.g*., IRS Private Letter Ruling 201614009 (April 4, 2016).[18]

As in PLR 201614009, a REIT (or REIT-owned partnership's) transfer of an energy tax credit pursuant to section 6418 without affecting the prohibited transactions tax safe harbor is consistent with Congressional intent both to encourage REITs to make green energy investments eligible for such credits and their transfer without otherwise affecting their eligibility for the prohibited transactions tax safe harbor. A tax credit that is transferable under section 6418 reflects the tax savings that are derived from

[14] S. Rep. No. 938, 94th Cong., 2d Sess. 470 (1976).
[15] S. Rep. No. 95-1263, 95th Cong., 2d Sess. 178-179 (1978).
[16] Section 857(b)(6)(C)(iii)(I) and (D)(iv)(I).
[17] Section 857(b)(6)(C)(iii)(II) and (D)(iv)(II).
[18] ("In the present case, Taxpayer's proposed section 1031 transactions appear to be consistent with the Congressional intent of allowing REITs to modify their portfolios without incurring a prohibitive tax. Accordingly, if each proposed section 1031 transaction satisfies the requirements of section 1031(a) and the Regulations thereunder, it will not be treated as a sale for purposes of the prohibited transaction safe harbor rules under section 857(b)(6)(C)").

an investment in certain clean energy projects such as rooftop solar panels and electric vehicle recharging stations, including those that may be attached to real property owned by a REIT. The transfer of these credits merely facilitates the investment in these projects and should be treated differently than the sale or other disposition of these projects or the property that they are attached to for purposes of the prohibited transaction tax.

Furthermore, investment tax credits such as those eligible to be transferred under section 6418 are subject to 100% recapture under section 50(a)(1) if the underlying investment credit property is disposed of within the relevant recapture period, and recapture applies to the transferee of an eligible credit (along with a 20% penalty to the transferee absent reasonable cause), which also should alleviate any concerns with not applying the prohibited transaction tax (which is applied annually) to the transfer of eligible tax credits under section 6418.

Therefore, Nareit requests confirmation that transfers of eligible tax credits are not considered dealer sales for purposes of the prohibited transactions tax rules.

b. Confirm that sales of energy under sections 45 and 45Y are not dealer sales under the REIT prohibited transaction tax rules

In order to encourage clean energy production, the IRA also provides for energy tax credits under sections 45 and 45Y with respect to certain energy production if such energy is sold to unrelated persons during the year. Consistent with Congressional intent both that REITs use the new and/or enhanced energy credits to provide significant climate benefits and that the prohibited transactions tax is meant to ordinary retailing activities such as sales of **real property**, Nareit requests that the IRS similarly clarify that sales of energy under sections 45 and 45Y are not dealer sales under the REIT prohibited transactions tax rules.

3. 75% REIT Asset Test

As noted above, every quarter, at least 75% of a REIT's assets must consist of real estate assets, cash and cash items and government securities. The treatment of a transferable tax credit that has not yet been transferred under the quarterly 75% REIT Asset Test may be unclear because of the latent cash value of the credit and because treatment for financial statement purposes is currently unclear

In applying the 75% REIT Asset Test by analogy, it would appear that a transferable tax credit that has not yet been transferred should either be treated as a receivable (which meets the 75% REIT Asset Test definition of cash and cash items) or excluded from the 75% REIT Asset Test calculation as a reduction in the basis of the property giving rise to the credit (even if such basis reduction would be zero under the

relevant provision such as section 50(c)).

Accordingly, Nareit recommends confirmation that to the extent that a transferable tax credit that has not yet been transferred, it is considered a real estate asset, cash, or cash item for purposes of the 75% REIT Asset Test.

4. Transferred energy credits earned through partnerships

In the United States, most real estate is held by partnerships or limited liability companies. Further, public REITs often are structured as "UPREITs" in which the REIT is a holding company that owns an interest in an operating partnership, which holds all of the REIT's properties.[19] Nareit reiterates the request in the Oct. 28, 2022 letter by nine real estate trade associations including Nareit that the IRS confirm that a partnership can elect both the direct pay option under section 6417 for its tax-exempt partners and the transferability option under section 6418 for its taxable partners (including REITs).

5. Election Procedure

Notice 2022-50 requests comments regarding the procedure to be used by taxpayers to elect to transfer eligible tax credits, such as elections by partnerships and S corporations (including the time and manner of such elections, the transfer of a portion of an eligible tax credit, and allocation of amounts received by a partnership or S corporation upon the transfer of a credit), any other provisions outside of section 6418 that would apply to a taxpayer electing to transfer credits, and documentation or information reporting requirements arising from an election.

While general recommendations concerning these issues are outside the scope of this submission, Nareit recommends that there be a clear and simple mechanism to make this election, preferably separately from a tax return.

The IRA eliminated prior law's limit in sections 50(d)(1) (applying rules similar to those in section 46(e) as in as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) that limited a REIT's eligibility for an energy tax credit to a proportionate amount equal to the proportion of retained income by the REIT. Since a REIT could not retain more than 10% of its REIT taxable income, at most REITs were eligible for 10% of any applicable credit.

Following amendment by the IRA, section 50(d)(flush language) now provides "[i]n the case of a real estate investment trust ***making an election*** under section 6418, paragraphs (1)(B) and (2)(B) of

[19] The UPREIT structure was explicitly addresses and approved in an example in the partnership anti-abuse regulations. Treas. Reg. § 1.701-2(d), Example 4.

the section 46(e) referred to in paragraph (1) of this subsection shall not apply to any investment credit property of such real estate investment trust to which such election applies." (Emphasis added).

A REIT-transferor needs to actually elect to transfer an energy tax credit in order to be eligible for the full value of the credit; thus, certainty as to how and when to make the election is important. One potential model for such an election requiring documentation between the transferor and transferee of an investment tax credit could be the election procedure in Treas. Reg. § 1.48-4(f)(1) (permitting certain lessors to pass through investment tax credits to a lessee). Nareit recommends that the election be due not earlier than 75 days after the date of transfer, similar to due dates for a REIT's taxable REIT subsidiary election on Form 8875, as well as "check-the-box" entity classification elections on Form 8832.

C. Conclusion

Nareit appreciates the opportunity to submit comments on pending regulations and other administrative guidance to implement the IRA clean energy tax credits and incentives. We would be pleased to discuss these comments if you believe it would be helpful. Please feel free to please contact me at (202) 739-9408, or tedwards@nareit.com or Dara Bernstein, Nareit's Senior Vice President & Tax Counsel, at (202) 739-9446 or dbernstein@nareit.com.

Respectfully submitted,

Tony M. Edwards
Senior Executive Vice President