sunrun

Via Federal eRulemaking Portal at www.regulations.gov

Internal Revenue Service
CC:PA:LPD:PR (Notice 2022-50), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

The Honorable Lily L. Batchelder
Assistant Secretary for Tax Policy
United States Department of the Treasury
1500 Pennsylvania Ave., N.W., Room 3120
Washington, DC 20220

November 3, 2022

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

Dear Assistant Secretary Batchelder:

We write to request a meeting and to provide comments in response to Notice 2022-50[1], Request for Comments on Elective Payment of Applicable Credits and Transfer of Certain Credits (the "**Notice**"). We appreciate the work of the staff at your office and the Internal Revenue Service ("**IRS**") to issue the Notice and prioritize guidance that will facilitate the use of both the direct payment regime and the transferability regime to obtain the full benefits of energy tax credits provided in the Inflation Reduction Act of 2022 (the "**IRA**").

We request guidance on certain important questions that were left open in the IRA as to the transferability regime and direct payment regime, as well as clarification of certain other related provisions in the Internal Revenue Code ("**Code**").[2] We believe our requests for clarification will provide more certainty to developers and investors who are collaborating to establish new renewable energy projects and provide much-needed liquidity to the market for such projects, which fulfills the Congressional intent in enacting the transferability regime and direct payment regime.

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[1] 2022-43 I.R.B. 325 (October 5, 2022).

[2] All references herein to "Section" refer to the Code.

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I. Our Background

Founded in 2007, Sunrun is a U.S.-based provider of photovoltaic ("**PV**") solar energy generation systems and battery energy storage products, primarily for residential customers. Sunrun's principal business model is to design, develop, install, sell, and maintain residential solar energy systems throughout the United States. Sunrun also sells solar energy systems and products, such as panels and racking, and offers battery storage solutions to residential homeowners.

In contrast to utility-scale or community-scale solar, Sunrun is a participant in "distributed generation." This refers to technologies that generate electricity at or near where it will be used.[3] Figure 1 below shows an example of distributed solar in which solar panels are installed on rooftops in a residential neighborhood. Distributed solar is frequently financed by investment funds that purchase the solar systems. These investment funds typically own thousands of individual solar systems, where those solar systems are installed on residential rooftops at different locations throughout the United States.

Figure 1. Distributed solar—solar panels installed on customer rooftops.[4]

Since inception, Sunrun's business model has focused on power purchase agreements ("**PPA**"), under which Sunrun installs and maintains a solar system on a customer's home, then sells power to customers at a contractually agreed-upon rate for a fixed term. This

[3] *See* U.S. Environmental Protection Agency, Distributed Generation of Electricity and its Environmental Impacts (July 14, 2021), https://www.epa.gov/energy/distributed-generation-electricity-and-its-environmental-impacts.

[4] *See* National Renewable Energy Laboratory, Go-Solar Enables Utilities To Efficiently Manage Millions of Solar Photovoltaic Devices (June 29, 2020), https://www.nrel.gov/news/program/2020/go-solar-enables-utilities-to-efficiently-manage-solar-pv-devices.html.

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allows the residential property owner to install solar property at little to no upfront cost, while allowing Sunrun to retain any tax benefits, including depreciation and tax credits, as the owner of the solar property.

Project developers like Sunrun, however, do not have sufficient capital to provide the up-front capital to purchase and install solar energy systems on homes (and wait for monthly PPA payments to recoup their costs over 20 to 25 years), nor do they have the taxable income necessary to absorb the sizable investment tax credits offered by Congress. Banks, however, do have the sizable capital needed to absorb the up-front costs of solar energy systems, and the taxable income to make use of the investment tax credits.

Given this economic reality, policy thinkers envisioned the use of common tax-equity financing structures to capture the incentives, particularly the sizable federal tax incentives, in the most efficient manner possible.[5] These structures – sale-leaseback, partnership flip, and inverted lease – have a long history in non-solar sectors such as wind energy (since the 1980s), traditional energy generation (in the 1980s), low-income housing (since the 1980s), and rail cars (in the 1950s).[6] According to the SunShot Initiative, "[f]inancing is critical to solar deployment, because the costs of solar technologies are paid up front, while their benefits are realized over decades. Solar financing has been shaped by the government incentives designed to accelerate solar deployment. This is particularly true for federal tax incentives, which have spawned complex tax-equity structures that monetize tax benefits for project sponsors who otherwise could not use them efficiently."[7]

Allowing customers to avoid the upfront cost of purchasing the solar energy system places the risk of solar financing squarely on solar developers. As Dr. O'Sullivan and Charles Warren observed in "Solar Securitization: An Innovation in Renewable Energy Finance," the lease and power purchase products offered by solar developers, while innovative and market-driven, nonetheless expose solar developers to significant risks:

> In the lease/PPA Model, solar providers must constantly manage three primary flows of cash and incentives to create value: (i) contracted payments with households, (ii) state credits for the electricity produced, and (iii) federal government tax credits and the investors in them. Examining the three value

[5] David Feldman and Mark Bolinger, "Emerging Opportunities and Challenges in Financing Solar", U.S. DEPARTMENT OF ENERGY, SunShot Initiative, Section 3.1 Common Tax-Equity Financing Structures, p. 10. https://www.nrel.gov/docs/fy16osti/65638.pdf.

[6] *Id.*

[7] *Id.*; *see also*, U.S. DEPARTMENT OF ENERGY, SOLAR ENERGY TECHNOLOGIES OFFICE, "On the Path to Sunshot: Executive Summary," https://www.energy.gov/sites/prod/files/2016/05/f31/OTPSS%20-%20Executive%20Summary-508.pdf.

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> streams of residential solar further elucidates the ingenuity of the business model but also demonstrates the risks that solar providers must manage . . .
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> . . . The flow of incentives and customer payments combine to make the third-party owned business model an attractive value proposition to households. However, they also introduce complexity and risk; the solar provider has to manage all three value streams simultaneously, each of which presents a unique set of challenges and time horizons. Federal policies and state regulations are difficult to predict let alone influence. The business model can be particularly susceptible to exogenous shocks in the form of policy and regulation. In addition, managing the customer relationship, including the associated credit and technology risks, presents other challenges.[8]

Congress intended to incentivize this kind of investment by making solar energy property eligible for the investment tax credit under section 48 (the "**ITC**"). This form of ownership has significantly helped make solar affordable for a large number of customers because it allows the solar energy system to be installed without the customer having to make the upfront investment to purchase the system. Benefits of distributed solar include: (1) eliminating the need to inefficiently carry electricity for great distances; (2) utilizing land that is already developed to generate the electricity rather than large tracts of undeveloped land; and (3) the potential to form virtual power plants by aggregating electricity output from individual households to support the electrical power grid and avoid power outages in times of capacity constraints, a powerful future state enabled by the rapid deployment of storage and the proliferation of solar systems on residential homes.

II. Executive Summary

Sections 6417 and 6418 of the Code, as enacted by the IRA, reflect a new and innovative approach by Congress to further incentivize developers, sponsors, and other parties to receive the full benefits of tax credits under the IRA. The ability of certain taxpayers to elect to treat certain credits as a direct payment rather than a credit against their federal income tax, and other taxpayers to transfer credits for cash, is intended to greatly expand the universe of potential counterparties and investors in energy projects, which will incentivize the development and deployment of technologies to address climate change through a variety of means. For example, schools and churches, under direct pay, can now situate solar panels on their existing rooftops to contribute towards electricity generation for on-site consumption, at a much-reduced cost.

[8] *See* "Solar Securitization: An Innovation in Renewable Energy Finance," by Dr. Francis M. O'Sullivan and Charles H. Warren, July 2016, MIT Energy Initiative, p. 8. https://energy.mit.edu/wp-content/uploads/2016/07/MITEI-WP-2016-05.pdf.

We note that the congressional intent behind the IRA is to increase investor demand for tax credits as, in this way, the near-term goal of creating and retaining jobs is achieved, as well as the long-term benefit of expanding the use of clean and renewable energy and decreasing our dependency on non-renewable energy sources. These factors are indicated in the IRA's Congressional record during the Senate debate and passage of the bill, where Senator Cardin stated the IRA's purpose succinctly: "Inflation is also too high, but its root causes are COVID-19 pandemic-related supply chain disruptions and Vladimir Putin's war on Ukraine. The IRA tackles these disruptions by promoting domestic manufacturing and supply chains and reducing our reliance on foreign energy."[9]

More specifically with regard to direct pay and transferability, Senator Cardin in colloquy with Senator Wyden explains how the new regime was designed to open additional financing options to spur the growth of clean energy:

> "Mr. President, I rise today to engage in a colloquy with the distinguished chairman of the Senate Finance Committee, Senator Wyden. I want to comment on the transferable tax credit provision supporting sustainability in the bill…As the chairman knows, the bill includes a historic investment in tax credits and incentives to promote the development of various clean energy technologies and ***provides a broad regime to permit eligible credits to be transferred from the project owners to another unrelated taxpayer***. Under current law, the ability to claim general business tax credits is subject to a number of potential limitations in section 38…based on the taxpayer's income tax liability. The bill language does not appear to apply the section 38 limitations to reduce the amount of the credit eligible to be transferred by the transferor of tax credits. ***This would be consistent with the goal of encouraging additional investment by expanding the availability of these tax credits to project owners without regard to their ability to claim the credits themselves.***"[10] (emphasis added).

Senator Wyden confirms Senator Cardin's statements above, and Senator Cardin goes on to conclude that the transferability and direct pay regime is intended to "***expand*** investment in projects that will achieve the broader climate goals of this bill."[11]

The ability of certain taxpayers to elect to treat certain credits as a direct payment rather than a credit against their federal income tax, and other taxpayers to transfer credits for cash, without collateral tax consequences, is intended to greatly expand the universe of

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[9] 168 CONG. REC. S4212 (2022) (statement by Sen. Cardin).

[10] 168 CONG. REC. S4166 (2022) (statement by Sen. Cardin).

[11] *Id.* (emphasis added).

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potential counterparties and investors in clean energy projects, which will incentivize the development and deployment of technologies to address climate change and create high-paying, quality American jobs through other prevailing wage, apprenticeship, and domestic content requirements for bonus credits embedded throughout the Code under the IRA. The direct payment regime will allow and incentivize certain "applicable entities" to enter into the pool of investors that invest in energy projects. The transferability regime will reduce the complexity that is normally involved in monetizing tax credits by allowing a buyer with sufficient tax capacity or access to the direct pay regime to simply purchase tax credits without acquiring a long-term ownership interest in the project as, for example, through a traditional tax-equity partnership. This will allow solar developers who typically have to rely on partnering with investors to have more flexibility in how they monetize such credits. Transferability will enable a market-based system, similar to the existing renewable energy certificate ("**REC**") system whereby project owners can incentivize tax credit buyers to purchase tax credits, presumably at a discount.

The pairing of transferability with direct pay can further propel Congressional vision in addressing climate issues, by enabling tax-exempt entities to (i) claim an ITC in a pass-through lease of equipment and then file for direct pay, (ii) purchase projects outright and receive a cash payment for the ITC, or (iii) purchase tax credits and then file for direct pay.

III. Key Recommendations/Requests for Clarification

This comment letter recommends that Treasury and the IRS adopt guidance that clarifies certain definitional aspects and substantive aspects of the direct payment regime in Section 6417 and the transferability regime in Section 6418. In particular, we request clarification on the following matters.

- *We recommend that the guidance clarify that governmental entities and instrumentalities, and all organizations referred to in Sections 401(a) and 501(a), are included in the term "applicable entity" in Section 6417, the direct payment regime.*

- *Clarify that if a lessor of an energy project elects to pass through the credits pursuant to Section 48(d)(1) (as in effect immediately prior to enactment of P.L. 101-508 (1990)), made applicable pursuant to Section 50(d)(5)) to an "applicable entity" under Section 6417(d)(1) that is a lessee of the project, such lessee is eligible to receive direct payment under Section 6417.*

- *Clarify that the passive loss rules under Section 469 and the at-risk rules under Section 465 will not apply to an applicable entity electing direct pay under Section 6417. In addition, clarify whether such rules apply to a transferor or transferee of tax credits under Section 6418.*

- What is the meaning of the term "cash" in Section 6418? *We recommend that the guidance interpret the term broadly to include purchase debt, notes and other instruments with delayed payments with a reasonable term.*

- What is the intended meaning of the term "taxpayer" in Section 6418 for purposes of determining to whom credits can be transferred? *We recommend that the guidance clarify that (1) "taxpayer" be interpreted broadly to include, without limitation, governmental entities and instrumentalities, pension funds, charities, S corporations and partnerships and (2) such parties may elect to receive direct payment under Section 6417 if they are "applicable entities." Further, if in such case there is an "Excessive Credit Transfer" under Section 6418 and an "Excessive Payment" under 6417 for the applicable entity, guidance should clarify that only one penalty applies.*

- What flexibility exists with respect to the allocation of tax-exempt income and cash where a transferor-partnership sells tax credits? *We recommend that the guidance provide flexibility to allow for special allocations of the cash and the tax-exempt income generated from the sale of credits, under Section 704(b) and the regulations thereunder.*

- To what extent may the transferor or other third parties insure, indemnify or otherwise guarantee the tax credits purchased by a transferee under Section 6418? *We recommend that a purchaser of the tax credits that files the proper tax forms is entitled to the purchased credits regardless of the guarantees, insurance or other protection provided to the purchaser by the transferor or a third party.*

- *We recommend that Treasury and the IRS issue guidance coordinating the transferability regime in Section 6418 and the new corporate alternative minimum tax ("AMT") regime in Section 56A by providing that tax-exempt income from the sale of credits is not included as income for purposes of computing adjusted financial statement income ("AFSI").*

IV. Statutory Background

A. Section 6417

Section 6417 allows an "applicable entity" to "elect" to convert an "applicable credit" into a deemed payment of tax equal to the amount of the credit. The electing taxpayer would then file for a refund from the IRS for this deemed tax "payment."

"Applicable entity" is defined as (among others) (i) any organization exempt from the tax imposed by subtitle A, (ii) any State or political subdivision thereof, (iii) the Tennessee Valley Authority, (iv) an Indian tribal government, (v) any Alaska Native Corporation Act

(43 U.S.C. 1602(m)), or (vi) any corporation operating on a cooperative basis which is engaged in furnishing electric energy to persons in rural areas.

"Applicable credit" includes various new and revised credits under the IRA. Generally, taxpayers are permitted to make direct payment elections for taxable years beginning after December 31, 2022 through December 31, 2032. Importantly, in the case of the production tax credit described in Section 45(a), any election for direct payment (i) applies separately with respect to each qualified facility, (ii) must be made for the taxable year in which the qualified facility is originally placed in service, and (iii) applies to such taxable year and to any subsequent taxable year which is within the period described in the production tax credit period set forth in Section 45(a)(2)(A)(ii) with respect to such qualified facility.

Finally, in the case of an "excess payment", the tax imposed upon the electing entity for the year is increased by the amount of the direct payment plus an amount equal to 20% of such payment.

B. Section 6418

Section 6418(a) permits "eligible taxpayers" to transfer eligible credits to an "unrelated" taxpayer. Section 6418(d) provides that a transferred credit is taken into account in the first taxable year in which the credit was transferred. Section 6418(e)(1) provides that any transferability election must be made no later than the due date (with extensions) for the tax return of the transferor, but no earlier than 180 days after enactment of the IRA. Any such election is irrevocable once made. Further, no subsequent transfers of the same credit for a particular tax year are allowed, under Section 6418(e)(2).

Section 6418(f)(1)(A) provides a list of eligible credits for purposes of the transferability regime. For purposes of the investment tax credit under Section 48, the transferability election must be made with respect to each separate facility for which a credit is available. For purposes of the production tax credit under Section 45 and related credits (*e.g.*, the Section 45V clean hydrogen production credit), the transferability election must be made with respect to each separate taxable year during the 10-year credit period (12-year period for purposes of the Section 45Q carbon sequestration credit).

Section 6418(f)(2) defines "eligible taxpayer" (*i.e.*, the transferor) to mean any taxpayer not described in Section 6417(d)(1)(A) (*i.e.*, a taxpayer other than a tax-exempt entity, governmental entity, or similar entity). In the case of an "excessive credit transfer," the tax imposed upon the transferee for such year is increased by the amount of the excessive credit transfer plus 20% of the amount of such transfer.

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Section 6418(g)(1) allows the Treasury to request information or registrations as a condition precedent to the transfer of any eligible credit, to prevent fraud, duplicate transfers, improper payments, or excessive payments of credits. Section 6418(g)(2) provides certain rules regarding "excessive credit transfers" to transferees. Section 6418(g)(3) provides special coordination rules for purposes of the recapture provisions in Section 50 with respect to the investment tax credit.

Section 6418 broadly provides that the transferee taxpayer, and not the eligible taxpayer, is treated as the "taxpayer" for all purposes of the Code with respect to the credit (or portion thereof) transferred. If a taxpayer elects to transfer all or a portion of a credit, the consideration for the transfer: (1) must be paid in cash, (2) is not includible in the transferor's gross income, and (3) is not deductible by the transferee. In the case of facilities or project property held by an S corporation or partnership, the entity must make the transferability election, in which case any consideration received from the transferee is treated as tax-exempt income under Sections 705 and 1366, for partnerships/LLCs and S corporations, respectively. Further, each partner or shareholder's distributive share of such tax-exempt income is based on such partner or shareholder's distribute share of the transferred credit that they otherwise would have been able to receive. No partner or shareholder can themselves make the transferability election; only the entity can make such an election.

Finally, the transferability regime is effective beginning 180 days after enactment of the IRA, and for taxable years beginning after December 31, 2022.

C. Section 56A

The IRA imposes a 15% corporate alternative minimum tax on AFSI of certain corporations with financial statement income exceeding specified thresholds. In general, under Section 55, a corporate AMT (book minimum tax) applies if the "tentative minimum tax" exceeds the taxpayer's regular tax for the tax year. The tentative minimum tax only applies to "applicable corporations" and is equal to 15% of AFSI minus certain foreign tax credit amounts. AFSI is adjusted by certain items, such as by including tax depreciation determined under Section 167 instead of book depreciation, and by not including amounts received as a result of a direct pay election under Section 6417. However, no such adjustment is provided to exclude from AFSI amounts that are received from the transfer of credits under Section 6418, even though Section 6418(b) provides that such amounts are excluded from gross income.

V. Clarification of Standards for Transfers of Credits

A. The Meaning of "Cash" in Section 6418(b) Should Include Purchase Debt, Installment Notes and Similar Obligations and Cash Equivalents

Section 6418(b)(1) requires the transfer of a credit to be for "cash" but does not provide clarity as to how this term is defined. Renewable energy projects, which can generate significant tax credits, often use more sophisticated means of transferring value between project partners and investors. For example, it is not clear that credits purchased for deferred cash payments by the purchaser are viewed as purchased for "cash" for this purpose. Taken to an extreme this could result in the invalidation of the tax credit transfer if the purchase payment is delayed by a day or even hours after closing. Similarly, it is difficult to discern why as a matter of policy a purchaser could borrow funds from a third party to finance the purchase of credits, but could not issue a purchase money note to the transferor of credits. We also note that for many purposes of the Code, cash equivalents, such as short-term securities, are treated in the same manner as cash.[12] Treasury should provide guidance that allows taxpayers to transfer generated tax credits for value, using a more expansive view of "cash."

B. Tax-Exempt Entities Should be Entitled to Be Transferees Under Section 6418(a)

Section 6418(a) provides that a transferor can elect to transfer credits to a "taxpayer." The statute does not further define who is considered an eligible transferee. Section 7701(a)(14) defines "taxpayer" as "any person subject to any internal revenue tax." Section 7701(a)(1) defines "person" as "an individual, a trust, estate, partnership, association, company or corporation." Under these broad definitions, we suggest that a Section 401(a) or 501(a) entity, a governmental entity, or similar entity should be treated as a "taxpayer" for purposes of Section 6418. For example, Sections 511-514 of the Code subject certain tax-exempt entities to U.S. federal income tax on amounts of "unrelated business income." Moreover, in PLR 8443084,[13] the IRS ruled that entities that ordinarily do not themselves pay federal income tax are nevertheless treated as "taxpayers" under the Code if they are "subject to other internal revenue taxes such as the federal unemployment tax."

Further, Section 6418(g)(2) provides the "excess credit transfer" penalty regime, which generally requires the transferee to be liable for any credits that are reduced by the IRS on audit. For this purpose, the IRS may impose an amount of tax on the transferee

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[12] *See*, *e.g.*, Section 856(c)(4)(A) which treats "cash items" as "cash" for purposes of the REIT asset qualification test.

[13] July 25, 1984.

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"regardless of whether such entity would otherwise be subject to tax under chapter 1 [referring to income taxes]." Thus, Congress broadly construed the meaning of transferee taxpayer to include entities that would not otherwise be subject to federal income tax liability. This also appears to be consistent with the policy underlying these provisions, which is to bring tax-exempt entities into the market as investors in renewable energy projects.

Assuming that Section 6418 does indeed apply to an applicable entity, then such entity should be able to elect direct pay pursuant to Section 6417 notwithstanding the language in Section 6417(a) that references the "credit determined with respect to such entity," as pursuant to Section 6418 the transferee will be treated as the taxpayer with respect to any credits so transferred. In light of the foregoing, guidance is necessary in the case where it is found that the applicable entity claimed more tax credits than would be otherwise allowable with respect to such facility or property for such taxable year. In such case, there could be both an "excess credit transfer" and 20% penalty under Section 6418, and an "excess payment" and 20% penalty under Section 6417, with respect to one excess credit amount. We request that future guidance clarify that only one 20% penalty would apply with respect to the excess credits claimed by the taxpayer in such a scenario.

We also request that future guidance clarify the following with respect to "excess credit transfers" and "excess payments": (a) what additional information may be required to make a determination as to whether there has been an excess credit transfer or excess payment, (b) what is the time period for Treasury review, (c) what is the forum for excess payment determination appeal, if any, (d) what audit rights, if any, will the IRS have, and (e) generally, what is the process for reviewing, granting, and challenging awards. We read these provisions to imply that the same audit and appeals procedures that apply to any other tax return would apply in these cases, but would appreciate confirmation as to whether or not Treasury agrees.

C. Section 6418(c)(1) Should Permit Special Allocations of Cash and Tax Credits Among the Partners of a Partnership-Transferor

Section 6418(c) provides that in the case of a transfer of credits by a partnership with respect to any facility or property held directly by a partnership, (i) any amount received as consideration for a transfer described in such subsection shall be treated as tax exempt income for purposes of Sections 705 and 1366, and (ii) a partner's distributive share of such tax-exempt income shall be based on such partner's distributive share of the otherwise eligible credit for each taxable year. For example, if a partnership with two 50% partners sells a portion of its tax credits for $50, but retains $50 of unsold credits, each partner will receive (i) $25 of tax-exempt income and cash and (ii) a $25 allocation of tax credits. However, without further guidance, it appears that the partnership would not be able to allocate the $50 of cash and tax-exempt income to one partner, and the $50 of unsold credits

to the other partner. This stands in opposition to the apparent policy behind Sections 6417 and 6418, to allow taxpayers a choice between receiving cash for its tax credits (through direct payment or transfer) or reporting the tax credits on its tax return. It would also be the rare exception under the Code to have a specific partnership allocation rule rather than following the general partnership allocation rules of Section 704(b) and the regulations thereunder.

Instead, and consistent with Revenue Procedure 2007-65, we respectfully request that future regulations provide that taxpayers may allocate the tax-exempt income under the rules of Section 704(b) and the regulations thereunder. This will permit many more taxpayers to invest, for example, in production tax credit projects, which generate tax credits over an extended period of time. Currently, there are taxpayers that are concerned that they will not have the tax capacity in the future to absorb such tax credits. However, as a result of the enactment of Section 6418, they would now invest in these projects if they have the option in the future to cause the partnership to transfer credits for cash, and have the cash and tax-exempt income allocated to them.

D. Clarification that the Term "Applicable Entity" in Section 6417(d)(1) Should Include Any Organization Exempt from Tax Under Sections 401(a) and 501(a)

Section 6417(d)(1)(A)(i) provides that the term "applicable entity" includes, among other entities, "any organization exempt from the tax imposed by subtitle A." Although tax-exempt entities described in Sections 401(a) and 501(a) arguably qualify as an applicable entity under such language, we note that under Sections 511-514, such entities may be subject to tax on unrelated business taxable income. We therefore request that future regulations clarify that organizations described in Sections 401(a) and 501(a) are applicable entities for this purpose. We further encourage Treasury and the IRS to list as comprehensively as possible examples of other entities that are tax-exempt for this purpose and thus eligible for direct pay.

E. The Definition of AFSI in Section 56A(c)(9) Should Exclude Amounts Received on Transferability Elections

Under current accounting rules, any amounts received for credits for which a transferor makes a transferability election would result in financial statement income under relevant accounting guidance (GAAP). Section 6418(b) provides that payments received in cash for purposes of the transferability election are excluded from U.S. federal taxable income. However, there is no guidance in the IRA to indicate that such amounts are also excluded from AFSI for purposes of the corporate AMT.

We request that Treasury and the IRA issue guidance clarifying that the exclusion from gross income for cash received with a transferability election also extends to the corporate AMT in Section 56A, i.e., it should not be included in AFSI. We believe this is a necessary clarification, as large taxpayers otherwise may be disincentivized to invest in green energy projects if amounts received in exchange for the transfer are subject to the corporate AMT.

We also note that the Code allows a taxpayer to use tax depreciation to determine AFSI (instead of slower book depreciation), such that accelerated tax depreciation does not result in AMT liability. In the case of renewable energy production, however, the output of renewable energy facilities (e.g., wind or solar energy) receives no depreciation deductions, and instead the costs of production are capitalized into the cost of the energy produced. This capitalization of the accelerated tax depreciation would typically generate a loss in costs of goods sold for U.S. federal tax purposes, but would result in a lesser or no loss for book purposes using the slower book depreciation. This could result in AMT liability and unfairly discriminates against the renewable energy industry. We request that Treasury provide that tax depreciation (and not book depreciation) should also be used in determining the cost of goods sold for purposes of computing AFSI. This aligns with Congressional intent to adjust AFSI by including tax depreciation instead of slower book depreciation.

F. Clarification That an Applicable Entity Lessee to Whom Tax Credits are Passed Through Under Section 50(d)(5) May Elect Direct Payment Under Section 6417

Under Section 50(d)(5) and former Section 48(d), a lessor may elect to treat the lessee as the owner of the energy property for tax credit purposes. In such case, under a plain reading of the statute, the lessee should be able to elect to receive direct payment if it is an applicable entity. We request that future regulations specifically provide that this is the case.

G. Applicability of the Passive Loss Rules and At-Risk Rules to Sections 6417 and 6418

Section 469 provides that credits from "passive" activities of a taxpayer cannot be used to shelter income tax from other "nonpassive" (*i.e.*, active or portfolio income) activities. Under Section 49, no ITC is allowed for investment credit property to the extent that the property is financed with "nonqualified nonrecourse financing." However, a taxpayer is free to report tax credits on its return to the extent that the energy property is "qualified energy property."

It is not clear how these rules will interact with Sections 6417 and 6418. Under Section 6417, an "applicable entity" includes pension trusts exempt from tax under Section 401(a) but subject to tax on unrelated taxable income under Sections 511-514. The passive

loss rules apply to trusts and therefore should apply to such pension funds, especially where a pension trust invests in an energy project which generates unrelated business income tax ("UBIT"). Specifically, if the pension trust does not "materially participate" in a tax credit investment, the passive credit rules would prohibit the pension trust from using the credits to reduce its tax liability from other "active" UBIT activities of the pension fund. Similarly, if nonqualified nonrecourse financing is utilized to acquire a project, Section 49 prohibits taxpayers (including tax-exempts paying UBIT) from claiming credits with respect to the ITC property basis attributable to such financing. Clarification is needed whether such provisions would indeed limit the applicable pension trust from electing direct pay where it does not materially participate in the investment, and whether the use of nonqualified nonrecourse financing would reduce the credits available to the applicable entity for direct payment.

Under 6418(a), the transferee of a credit is "treated as the taxpayer for purposes of this title with respect to such credit." Here too, clarification is needed that neither Section 49 (such as where the transferee uses nonqualified nonrecourse financing to finance its purchase of credits) nor Section 469 would apply to a purchaser of the credits. With respect to the latter in particular, it is difficult conceptually to apply the passive loss rules to a purchaser of credits who is deemed to be the taxpayer, and arguably a "materially participating taxpayer," for purposes of the credits. Moreover, it would further the legislative purpose of expanding the universe of tax credit market participants if the at-risk and passive credit rules do not apply to the operation of Sections 6417 and 6418.

H. Guarantees of the Credits Acquired by the Purchaser

Under Section 6418, a taxpayer may purchase tax credits from an "eligible taxpayer," and include such tax credits on its return (or elect to receive direct payment in the case of an applicable entity purchaser). If the applicable investment credit property is disposed of, or otherwise ceases to be investment credit property with respect to the eligible taxpayer, before the close of the recapture period, it is the purchaser of the credits that will incur the recapture tax.

Presumably, the policy behind the enactment of Section 6418 is to expand the pool of investors to those who do not have the expertise and financial capability to invest in energy projects directly. However, as the purchaser is the party that bears the recapture risk, it will be difficult for such parties to so enter the market for tax credits. Rather, for the transfer provision to be utilized in furtherance of the congressional purpose in its enactment, it will be critical that purchasers have the ability to obtain contractual protection for the purchased credits, either through warranties, indemnities and guarantees provided by the transferor or by third party insurance or financial guarantor companies. Assuming contractual protections are extensive and truly protect the purchaser of the credits from all or substantially all of the risks from the failure of the applicable investment tax credit property, the issue raised is

whether the purchaser is the true owner of the purchased credits under federal income tax law principles.[14] If such principles are applied in such instance, it will preclude or limit the use of such contractual protections and would greatly limit the usefulness of Section 6418.

In light of the foregoing, we recommend that future regulations provide that the purchase of credits be respected regardless of the inclusion of such contractual protection provisions. This will enable many smaller taxpayers to participate in the tax credit market and increase the available financing options for renewable energy projects.

VI. Summary/Conclusion

In summary, we recommend that Treasury provide the following guidance in proposed regulations regarding the direct payment regime, transferability regime, and the interplay of both with the corporate AMT provisions.

- The proposed regulations should confirm and adhere to Congressional intent that all tax-exempt entities for U.S. federal income tax purposes, including governmental entities and instrumentalities, should be treated as eligible taxpayers for purposes of both the direct payment regime and the transferability regime.
- The proposed regulations should clarify that in an inverted lease structure, an applicable entity that is a lessee may elect direct payment under Section 6417.
- The proposed regulations should clarify the applicability or lack thereof of the passive loss and at-risk credit rules to Sections 6417 and 6418.
- The proposed regulations should adopt clear standards for what is considered "cash".
- The proposed regulations should clarify that all tax-exempt entities for U.S. federal income tax purposes are able to purchase credits and utilize the direct payment regime, and that only one penalty would apply in such case if there is an "excessive credit transfer" and "excess payment" with respect to the same tax credits claimed by the taxpayer.
- The proposed regulations should allow partnership-transferors to specially allocate tax-exempt income from the sale of the credits to its partners when making a transferability election.

[14] *See*, *e.g.*, *Historic Boardwalk Hall, LLC v. Comm'r*, 694 F.3d 425, 450, 454-55 (3d Cir. 2012); *Frank Lyon Co. v. United States*, 435 U.S. 561, 572-73 (1978); *Calloway v. Comm'r*, 135 T.C. No. 3 (July 8, 2010); *Grodt & McKay Realty, Inc. v. Comm'r*, 77 T.C. 1221, 1237 (1981).

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- The proposed regulations should clarify that a purchaser of credits may report such credits on its return regardless of the extent of the guarantees or contractual protections that it receives from the seller of the credits or a third party.

- The proposed regulations should provide for an adjustment to AFSI under the new corporate AMT provision to (i) exclude from AFSI income from the sale of credits and (ii) utilize tax depreciation in determining the cost of goods sold for purposes of AFSI.

We appreciate your consideration of the recommendations and requests for clarifications discussed above and look forward to the issuance of proposed regulations and other guidance that will facilitate much-needed investment in facilities and property to reduce greenhouse gas emissions and overall advance the climate-focused policies underlying the IRA. We request the opportunity to convene with Treasury and the IRS to discuss these issues in more detail and to answer any questions. In the interim, please do not hesitate to contact us at Shirley.Chin@sunrun.com.

Warm Regards,

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