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January 19, 2023

SUBMITTED ELECTRONICALLY

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

Ms. Holly Porter
Associate Chief Counsel
Passthroughs and Special Industries
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

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

RE: Notice 2022-50 and Sections 6717 and 6718 of the Internal Revenue Code
Request for Meeting and Review of Comments

Dear Ms. Porter and Ms. Batchelder:

On behalf of my clients, a section 501(c)(3) public charity and its affiliated charitable trust, I submit this request for a meeting and consideration of the comments below, submitted in response to IRS Notice 2022-50. These comments specifically address the classification of tax exempt organizations for purposes of implementation of certain energy tax credit provisions recently enacted as part of the Inflation Reduction Act. It has come to our attention that there are vague provisions defining tax exempt entities and the statutory limitations on energy tax credits as to these entities. To encourage tax exempt entities, such as my client, to

invest in qualifying energy projects, we respectfully request that Treasury and the IRS clarify a few specific provisions.

Although we recognize that the deadline for submitting comments was November 4, 2022, we hope that you will consider these written comments and that said consideration will not delay the issuance of guidance. Accordingly, we respectfully request clarification on the following points. The discussion below assumes that the "applicable entity" has made a qualifying election under Section 6417(a). These comments and request for clarification also assume that the entity's energy project qualifies for an energy credit outlined in the Inflation Reduction Act.

Section 6417(d)(1)(A)

As stated in Notice 2022-50, Internal Revenue Code section 6417(d)(1)(A)[1] defines the term "applicable entity" to mean, in part, (i) any organization exempt from tax imposed by subtitle A.

Subtitle A of Title 26 of the Internal Revenue Code encompasses income taxes set forth in sections 1 through 1563. An entity defined as exempt from tax pursuant to sections 501(a) and 501(c) is exempt from certain taxes within subtitle A of the Internal Revenue Code, but not all. For example, so-called "tax-exempt" organizations are subject to taxes on unrelated business income, as set forth in sections 511 through 514, during any taxable years when a tax-exempt organization engages in an unrelated trade or business. Therefore, at least during those years of engagement in unrelated activities, a section 501(c) organization would not be exempt from a tax imposed by subtitle A. Arguably, a section 501(c) organization is never totally exempt from the imposition of taxes under Subtitle A. Whether the tax applies is dependent upon the organization's activities in any given year, which is true of most taxpayers.

Another question is whether a section 4947 trust is an "applicable entity". A section 4947 trust is not exempt under section 501(a), but its assets are devoted to charitable purposes. It is generally called a "non-exempt charitable trust". Section 4947 states that it "shall be treated as an organization described in section

[1] All Section references are to the Internal Revenue Code of 1986 as amended.

501(c)(3)."[2] Is a nonexempt charitable trust an "applicable entity"? This raises another question: are estates and trusts generally "applicable entities"? They are not subject to taxes set forth in Subtitle A of the Internal Revenue Code, but rather are subject to taxes under Subtitle B. Trusts and estates are generally not considered to be tax-exempt.

We request that the language be clarified to better define the tax-exempt organizations that qualify as "applicable entities".

Section 6417(d)(2)(B)

Section 6417(d)(2)(B) states that the property used by the applicable entity generating the applicable credit[3] is to be treated as "used in a trade or business of the applicable entity". The issue is whether that trade or business is to be treated as related to the applicable entity's charitable purpose and thus not subject to the unrelated business income tax. Because the statute specifies that the amounts attributable to the tax credits are generally exempt from tax for partnerships and S Corporations[4] it makes sense that the energy tax credits received by tax-exempt organizations would also be exempt as a "related" trade or business pursuant to section 512. However, that is not clear. If the statutory tests for an unrelated business apply, the credits would be related income from a related trade or business for only a small subset of tax-exempt entities that have a charitable purpose related to climate change and renewable energy, unless further guidance is provided. If, in fact, the solar energy project or similar qualified energy project is not factually related to the applicable entity's charitable purpose, the charity needs to be assured that it will not be subject to section 512 and the unrelated business income tax on the amounts received from the energy credits. On the other hand, if the credits are taxed as unrelated business income, will the entity be able to offset that income from an unrelated business from other unrelated trades or businesses? It would appear not, due to recent Treasury Regulations.[5]

[2] Section 4947(a)(1)
[3] Section 6417(b)
[4] Section 6417(c)(1)(C)
[5] Treas.Reg. 1.512(a)-6: "Special rule for organizations with more than one unrelated trade or business". This Regulation section provides that each separate trade or business has to calculate gains and losses separately. One unrelated business' net losses cannot be used to offset revenue from another unrelated business' revenue.

Similarly, if subject to tax, it would follow that the otherwise tax-exempt organization would not qualify as an "applicable entity" and thus could sell the tax credits. More clarification is needed.

Pursuant to section 501(c)(3) and the statutory and regulatory rules regarding public support, another question that arises is how the credits will factor into the public support calculation. Assuming the credits received are treated as a related activity of the public charity, will the revenue be treated as public support for purposes of qualifying the organization as a publicly supported 501(c)(3) charity?[6] Clarification is needed.

Section 6418(b)

Section 6418(b) allows "eligible taxpayers" to sell the credits to unrelated third parties, called "transferee taxpayers". The IRS treats the transferee taxpayers as the taxpayers earning the credit. The "eligible taxpayers" are to be paid in cash and it is not includible as gross income of the "eligible taxpayer" nor is the payment deductible by the "transferee taxpayer". An "eligible taxpayer" is defined as any taxpayer that is NOT defined in section 6417(d)(1)(A). This apparently means that an eligible taxpayer is not a tax-exempt organization. However, the questions raised above in defining the term "applicable entity" also carry through to concerns relating to whether tax-exempt organizations are precluded from selling the credits since they would not qualify as "eligible taxpayers". On the other hand, if a tax-exempt organization routinely has unrelated business taxable income, could it then be outside the definition of "applicable entity" and so could be an "eligible taxpayer" and able to sell the credits to unrelated third parties? Clarity is needed on these issues.

Related Trade or Business?

A final issue that needs clarification is whether the standard unrelated trade or business statutory rules apply to the tax-favored renewable energy projects and the generation of income from the sale of the energy produced by the tax-exempt organization's energy project. Because the energy is subsidized through tax credits, it is logical to assume that the tax-exempt entity could also enjoy tax-free

[6] *See* Treas.Reg. §1.509(a)-1; Treas.Reg. §1.509(a)-3.

treatment of the revenue derived from its energy activities generating the tax credits. Clarity would be welcome as to whether sections 511 through 514 would apply similarly to this activity as applied to other activities that are unrelated to the charity's tax-exempt purpose. There are arguments that the activity would generate passive income similar to rent or royalties, which is exempt from unrelated business taxable income. Clarity is needed as to whether those exemptions would include the ongoing income stream from a tax-exempt entity's investment in the energy project. Also, if the project is debt-financed, whether the section 514 provisions apply to render the income stream taxable.

EXAMPLES

Applying what we consider to be common sense conclusions to the above questions, we propose several examples that could be adopted as part of the guidance. These examples are also intended to highlight ancillary issues that arise. For purposes of these examples, we are assuming that the entity and its energy project meets all of the requirements to qualify in the first instance for the energy credits and so the discussion involves "applicable credits" as defined in section 6417(b). We also assume that the entity timely makes the election pursuant to section 6417(a).

Public Charity

A tax-exempt organization ("Charity") is defined in section 501(a) and 501(c)(3) and constructs a solar farm on its extensive real property. Charity will be classified as an "applicable entity" under section 6417(d)(1)(A) and the revenue it receives from the refundable energy credits will be treated as tax free, from a related trade or business pursuant to section 6417(d)(2)(B). Charity accounts for the tax credits as public support similar to government grants, for purposes of the public support test. Charity is prevented from selling the tax credits to an unrelated third party pursuant to section 6418(b). However, Charity is able to sell the energy produced by its solar farm and receives substantial revenue from the sale of the solar energy. The solar energy activity is also considered a related trade or business.[7] The revenue from the energy credits and the revenue received from the sale of the solar energy produced on its property is

[7] Alternately, this could be classified as a passive activity, and excluded from the unrelated business income tax under section 512(b).

much greater than the revenue Charity receives from other sources. However, pursuant to sections 6417 and 6418, Charity's exempt status is protected and the revenue it receives in the form of refundable tax credits plus the revenue from the sale of its production of energy is not subject to taxes and is classified as public support.

Nonexempt Charitable Trust

A section 4947 nonexempt charitable trust ("Trust") owns extensive real property. The Trustee decides to invest the Trust's assets in a solar energy farm. Under the statute, it is to be treated the same as a section 501(c)(3) public charity and so the Trust is classified as an "applicable entity" under section 6417(d)(1)(A). The energy tax credits it receives cannot be sold, but are not taxable to the Trust. Additionally, since the Trust is to be treated the same as a public charity under section 4947(a)(1), the revenue it receives from the sale of the energy produced on its property is also exempt from taxes.

Private Foundation

A private foundation ("Foundation"), recognized as tax exempt under sections 501(a) and 501(c)(3), constructs a solar farm on property owned by the Foundation. It is classified as an "applicable entity" pursuant to section 6417(d)(1)(A). The energy produced on Foundation's property is sold to unrelated third parties. The revenue received from the unrelated third parties is subject to the section 4940 excise tax on investment income.[8] However, the revenue would not be subject to any of the other private foundation excise taxes.

To wit:

Section 4941: The revenue is not classified as self-dealing under section 4941 as long as the revenue is ultimately used for charitable purposes.

Section 4942: The revenue would be included in the Foundation's current year income and would become part of the formulaic process of determining the amount of income the Foundation is required to distribute each year pursuant to

[8] The section 4940 tax on the investment income of private foundations is currently 1.39%.

section 4942. Assuming the requirements of section 4942 are met and there is no failure to distribute the income of the trust, the Foundation is not subject to the section 4942 excise tax for a failure to distribute income.

Section 4943: The revenue is from unrelated third parties and so the excise tax on excess business holdings pursuant to 4943 is not applicable. However, if the Foundation establishes a separate corporate entity to house the energy activities, the excise tax on excess business holdings could be applicable.

Section 4944: The investments in renewable energy are not classified as jeopardy investments, and so the excise tax under section 4944 is not applicable.

Section 4945: None of the funds used by the private foundation to build and support the renewable energy project are classified as taxable expenditures under section 4945.

If the above scenarios are not correct interpretations of sections 6417 and 6418, clarification needs to be provided by the IRS and Treasury. As indicated, the discussion above assumes that the “applicable entity” has made a qualifying election under Section 6417(a).

The charitable sector would also benefit from guidance as to the tax treatment of a tax-exempt organization if an election is not timely made by the applicable entity, as described in section 6417(a). If the entity has no taxable income, is the credit lost? Or, if the charitable entity is liable for the unrelated business income tax, will the credit offset that income tax on Form 990-T? Some of the elections under section 6417 are irrevocable. What happens if a charity has unrelated business income tax liability in year one but not in years 3 or 5? Clarity would be welcome.

Thank you in advance for your consideration of these issues. I request the opportunity to meet with Treasury and IRS officials to discuss these issues, and to answer any questions that you may have.

Respectfully yours,

Nancy Ortmeyer Kuhn

Nancy Ortmeyer Kuhn, Esq.