NEW MEXICO
TAX CREDIT ALLIANCE

November 3, 2022

Via Overnight Mail and Electronically Filed

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

Re: Comments Responsive to IRS Notice 2022-50; Transfers of Tax Credits Pursuant to IRC Section 6418

Dear Representative:

Please find attached our comments in response to IRS Notice 2022-50.

Thank you for this submission opportunity regarding the upcoming federal transferable income tax credit system.

Ethan Epstein

Enclosure

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COMMENTS IN RESPONSE TO IRS NOTICE 2022-50 SOLITICING INPUT REGARDING DIRECT TRANSERABILITY OF INCOME TAX CREDITS PROVIDED FOR IN THE INFLATION REDUCTION ACT

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I, together with my associated organizations, have been involved with direct transfer of state tax credits for the last twenty years. We promoted the enactment of the tax credit transfer legislation for direct transfer of multiple state tax credits; we have transferred various different kinds of transferable state tax credits (primarily in the green space and the renewable energy space) and are very experienced in the tax credit transfer process. We have transacted state tax credits to tax credit buyers throughout the Country in substantial amounts. Because of this, we are very familiar with various technical issues within the transferable tax credit arena as well as the procedures that have been utilized to allow and track such direct transfers at the state level. These comments suggest the forthcoming Regulations address similar considerations in effecting the newly enacted tax credit transferability system.

These comments summarize issues responsive to IRS Notice 2022-50, which seeks public input pertaining to the upcoming transferable and direct payment tax credit system created by the Inflation Reduction Act and codified in 26 USC Sections 6417 (Direct Payment of Applicable Credit) and 6418 (Transfer of Certain Credits) (all provisions within the Internal Revenue Code are referred subsequently by section only). The below comments are generally limited to the transferability rules prescribed under Section 6418 and are bifurcated on an itemized basis into the following: (1) Technical Issues Concerning Transferable Tax Credits and (2) Recommendations to Administer the New Tax Credit System.

I. Technical Issues Concerning Transferable Tax Credits

There are several technical issues concerning the transferable tax credit rules prescribed by Section 6418. These issues include:

(A) Correct Taxable Year for Eligible and/or Transferee Taxpayer to Claim the Tax Credit: The statutory section concerning the taxable year in which a credit is taken into account is prescribed in Section 6418(d) which provides in pertinent part that a "credit shall be taken into account in the first taxable year of the transferee taxpayer ending with, or after, the taxable year of the eligible taxpayer with respect to which the credit was determined." This language is extremely important from a transactional standpoint, but confusing, as to timing issues in the transferee taxpayer's claiming of the transferred tax credit and should therefore be clarified especially in the context where fiscal and calendar year taxpayers are transferring tax credits between each other. One way that the Regulations could address this situation is to provide several examples, one where the transferee's tax year ends before the transferor's and one addressing the opposite situation and in each case indicating the tax year that would ultimately apply to the credits. In addition, adding scenarios involving different methods of accounting – where one taxpayer is a fiscal year taxpayer and the other a calendar year taxpayer – would be helpful and on point with many future tax credit transfers that will occur between entities.

(B) Guidance Concerning Carry Forward and Carry Back Rules: Section 6418(f)(1) removes from the definition of an eligible credit "any business credit carryforward or business credit carryback

determined under Section 39." Section 39 prescribes the carry forward and carry back rules for business income tax credits. Does this mean that an "eligible credit" cannot be used on any tax year other than the single tax year specified in Section 6418(d)? If so, that concept should be plainly explained in the Regulations because they could cause an unusual and potentially expensive expiration of the tax credit.

(C) Definition of Taxpayer: The statute contains two types of taxpayers: (1) an "eligible taxpayer" and (2) an "transferee taxpayer." The term "eligible taxpayer" is defined in Section 6418(f)(2) as "any taxpayer which is not described in Section 6417(d)(1)(A)," which essentially excludes six types of tax-exempt entities. However, the detail reference with regard to a "transferee taxpayer" is only statutorily found at Section 6418(a) as "a taxpayer ..... which is not related (within the meaning of 267(b) or 707(b)(1)) to the eligible taxpayer." Section 7701(a)(14) further defines "taxpayer" as essentially "includ[ing] an individual, a trust, estate, partnership, association, company or corporation." Given the broadness of the "taxpayer" definition found in Section 7701, other taxpayer type variations could occur, but there is no additional statutory limitation concerning the meaning of a "transferee taxpayer" and therefore no additional limitations should be imposed regulatorily. This analysis is consistent with the language in Section 6418(a) that "any" unrelated taxpayer regardless of their various types should be able to transfer tax credits between each other. This interpretation and system is established within many transferable state tax credit systems. *See* NMAC Section 3.13.20.15(A), which has similar taxpayer language allows for transfers between various entity types and individuals.

(D) Passive Activity Loss Limitations Are Generally Inapplicable to Direct Tax Credit Transfers: In addition, as a practical matter in the investor context, the Passive Loss Activity Rules prescribed in Section 469 do apply to "passive activity credits" and can bar consumption of the tax credits by passive investors. However, transfer of tax credits do not require – and as a practical matter will not involve investment in the entity owner of the energy renewable projections that produce the tax credits. Therefore, the passive activity rules are inapplicable to tax credit transfer situations because such an activity does not "involve the conduct of a trade or business" as required under Section 469(c)(1) to create a "passive activity." Accordingly, the limitation provisions of Section 469(a)(1)(B) – which bars a taxpayer's consumption of "passive activity credits" - in the absence of material participation and/or some other exception should not apply where a transferee taxpayer is not involved in the associated trade or business. The Regulations should provide clarity on this technical issue which has common application in the renewable energy tax credit space.

(E) Distributions to Entity Owners are Effectively Tax Credit Transfers: Many tax credit generators will be owned by entities comprised of several shareholders and partnerships. Section 6418(c)(2) is relevant to such ownership structures and provides in pertinent part that "no [transfer] election by any partner or shareholder shall be allowed." Thus, clearly, tax credit allocations to entity owners cannot, thereafter, be transferred by the allocated owner to a subsequent unrelated taxpayer. This is consistent with the one-time tax credit transfer rule codified in Section 6418(e)(2) which essentially provides that no transferee taxpayer can subsequently transfer the same tax credit. We recommend that the forthcoming Regulations include an example illuminating this concept. Consider, for example, Company A, equally owned by four shareholders, receives a

$10,000 transferable renewable energy tax credit. Pursuant to Section 6418(a), Company A elects to transfer $7,500 of that tax credit to an unrelated individual taxpayer, Taxpayer A, and the remaining $2,500 of tax credits owned by Company A is allocated to Shareholder B. The correct transactional and tax result is that Company A distributes the $7,500 in equal parts to Shareholders A, C and D as tax exempt income and Shareholder B must claim his $2,500 on his Income Tax Return.

(F) Gross Income Recognition for Discount Absorption: Under Section 61, gross income includes any accretion to wealth, and, therefore, transferee taxpayers', as an untested and theoretical concept, could report income on tax credit purchases commensurate to the economic value of the tax credit's discount rate. This general gross income rule is also tangentially recognized in cases like *Temple v. Commissioner*, 136 TC 15 (2011) where the US Tax Court held that transferable state income tax credits are capital assets with a zero basis and subject to tax on the gain from a tax credit sale. For illustration purposes, assume a transferee taxpayer purchases a $1 tax credit for 90 cents. Under *Temple* and the basic cost basis rule prescribed under Section 1012, that taxpayer would take the transferred tax credit with a 90-cent basis and would offset a $1 tax liability, representing a 10-cent gain to the transferee taxpayer. However, Section 6418(b)(2) prescribes that "any amount paid by the transferee ..... shall not be includible in gross income of the eligible taxpayer." This statutory exclusion directly addresses the taxation expressed by the Tax Court in *Temple* and, similarly, no income should be recognized anywhere within the tax credit transaction, including on the transferee side of the transaction; again, Congress clearly through the above income exclusion language tried to exclude federal tax from tax credit transfers and that concept is clearly expressed as to the tax credit transferring taxpayer. This interpretation treats the transferee and eligible taxpayers similarly to each other and any actual and/or theoretical wealth created by transferable tax credits should not be taxable to either taxpayer.

(G) Joint Ventures With Public and/or Tax Exempt Entities Must Transfer Tax Credits: There are several business realities that influence the creation of public private partnerships where a tax exempt entity could own a renewable energy operation together with a for profit taxpayer. Because these entities are distinct from their underlying owner and, often, could pay taxes, the tax credit transfer rules in Section 6418 would control monetization and eligible credit. In such an instance, the joint venture should not be able to receive a direct payment under Section 6417. Regulations demonstrating this delineation are important for tax credit monetization in these situations because it will essentially determine in these situations whether the tax credit must elect for direct payment pursuant to Section 6417 or, alternatively, elect for transferability pursuant to Section 6418.

II. Recommendations to Administer the New Tax Credit System

(A) Timing of Transfers: Transfers should be allowed to happen as soon as the Seller Taxpayer has completed all actions necessary to earn the tax credits. For solar and wind electrical generating facilities, this will typically be the date at which the facility goes into service. Under current tax equity transactions, the in-service date is typically when the tax equity investors fund their participation in the project (i.e., when the tax credits are paid for and the developer receives its payment for the tax credits). Direct transfer was intended to provide a lower-cost alternative to

tax equity funding. Thus, the transfer of the tax credits (and associated funding) must be allowed to happen at the same time as is the case with tax equity funding; otherwise, transferability would be at a competitive disadvantage, and legislative intent would not be realized.

(B) Documentation on Transfers: There is currently no documentation required to be provided to the Internal Revenue Service at the time of funding of a tax equity investment. Accordingly, there should be no documentation required to be provided to the Service in association with the transfer of a tax credit. The marketplace should be allowed to take account of matters related to due diligence and indemnification, just as is currently the case for tax equity investment; otherwise, tax equity transactions will have a competitive advantage over direct transfers, and the legislative intent to provide a low-cost alternative to tax equity will not be realized. If any documentation is required to be provided to the Service at the time of transfer, it should be limited to documents that would typically already be available in connection with the creation of the energy facility, and not additional documents that must be prepared for the Service.

(C) Tracking of Transfers: Currently, in the case of tax equity transactions, there is no immediate reporting to the Service that a payment related to allocation of tax credits has taken place, and the Service does not learn of such a funding payment and allocation of tax credits until tax returns are filed for the transaction (which is often more than a year later). To keep the playing field level, it would be reasonable to apply the same standards to direct transfers of tax credits. It may, however, be beneficial to the direct transfer marketplace to have some level of assurance that the transfer has been recognized in some manner by the Service. Such a recognition could theoretically avoid situations of accidental or fraudulent overselling of tax credits. Accordingly, it may be reasonable to require some sort of contemporaneous notice to be filed with the Service when a direct transfer of tax credits has occurred. Also, it might be reasonable to provide some sort of registry of the tax credits and their transfer, which would better allow the Service, and perhaps third parties, to keep track of tax credits.

(D) Moving Beyond the Status Quo: During the last decades, the transfer of alternative energy tax credits has, as a practical matter, been accomplished via tax equity transactions. In providing for direct transfer of the tax credits, Congress acknowledged that the tax equity system was burdensome and expensive, consuming up to 30% of the value of the tax credits, and making it difficult for smaller facilities to compete in the marketplace. During the time when passthrough allocation was the only means of monetizing tax credits, a substantial industry arose around tax equity. The participants in this tax credit industry have now made it clear that they wish to preserve the status quo regarding the industry, and to not allow a more efficient mechanism (direct transfer of tax credits) to displace the current system. Accordingly, many of the initial comments and observations from the tax equity industry have been directed toward trying to make sure that direct transfers are subject to the same burdensome high levels of due diligence and documentation that have evolved within the tax equity industry. In reviewing any such comments, the Service should be mindful that Congress has indicated its desire to provide for a more efficient means for transferring tax credits, and that doing away with, rather than perpetuating, the types of due diligence and documentation utilized by the tax credit industry is a specific goal of the IRA.