Comments to the Internal Revenue Service on the administration of sections 6417 and 6418 of the Inflation Reduction Act: elective pay and transferability

August 14, 2023

center *for* public enterprise

center *for* public enterprise
Putting the public sector back to work.

Jeff Gordon & Chirag Lala
August 14, 2023

Comments to the Internal Revenue Service on the administration of sections 6417 and 6418 of the Inflation Reduction Act: elective pay and transferability

The enclosed comments on the proposed rules for sections 6417 and 6418 of the Inflation Reduction Act highlight several administrative challenges for elective payment and transferability that Center for Public Enterprise believes must be addressed in subsequent rulemaking to maximizing the useful investment in clean energy technologies by applicable entities and particularly by the public sector. For newly eligible entities to make investments in clean energy assets, they must be provided a sense of predictability and certainty related to how particular actions or transactions, business models, and attributes of their projects will affect their eligibility to to claim elective pay. Only clear rulemaking can bring that certainty; in its absence, fewer projects will view direct pay as an option for financing clean investments.

Without clear rulemaking that enables elective pay we will remain in the situation that existed prior to the Inflation Reduction Act, when such eligible entities were unable to directly monetize tax credits and were relegated to partnerships which put them at a disadvantage relative to other parties, limiting potential investment in needed clean energy resources. The Inflation Reduction Act seeks to put these entities on a more level playing field. The Treasury Department and IRS can ensure that sections 6417 and 6418 enable the Inflation Reduction Act's intent to create significant increases in clean energy investment by making it possible for entities to plan with predictable answers to major administrative questions including the possibility of "chaining" elective pay to transferred credits, the eligible partnership or joint investment structures, and the eligibility of federal agencies to claim elective pay. The enclosed comments address each of these challenges and make recommendations for revisions and clarification from Treasury and the IRS.

I. Chaining

A. Chaining is the ability of an applicable entity (the transferee) to claim elective pay on credits transferred to them by an eligible taxpayer. The Treasury and IRS should change the decision to prohibit chaining in the Notice of Proposed Rulemaking (NPRM) of June 21, 2023.

Chaining would enable an additional avenue for tax-liable entities to monetize credits and thereby limit the cut of credit disbursements claimed by tax equity investors.[1] Chaining would allow public

[1] Credit Suisse estimated that investors are able to receive approximately 85 cents on the dollar for large projects. Jiang et al., *US Inflation Reduction Act: A Tipping Point in Climate Action* (2022) at 19.

authorities and other applicable entities with sufficient balance sheet space and incentive to monetize credits for taxpayers who might not otherwise have the fiscal space to hold projects until they receive regular credit disbursements. For example, green banks such as those established through the Greenhouse Gas Reduction Fund, and other public financing entities could purchase credits with the intention of claiming elective pay and thereby provide short-term financing against the medium-term cash flow associated with credits. In doing so, applicable entities would thereby provide a backstop source of bridge financing for tax-liable projects in the public interest, reduce financing uncertainty for projects claiming IRA tax credits, and reduce credit constraints in tax equity markets more generally. Ultimately, chained transactions would provide public entities (and nonprofits) with another tool to accelerate the development of energy projects and ensure that more IRA money ultimately contributes to that development.

In addition, the returns on chaining transactions enable green banks and other public entities to undertake other activities associated with decarbonization, such as providing necessary technical assistance to other elective pay eligible projects and/or to entities they lend to. Chaining also incentivizes governments to work more closely with special purpose vehicles set up to execute public energy development by providing them with bridge financing against the expected cash flows associated with elective pay eligible credits.

B. Chaining is allowable within the statutory scheme of the Inflation Reduction Act.

Read together, sections 6417 and 6418 provide the Secretary a basis to conclude that an entity eligible for elective pay can make an elective payment election with respect to credits transferred under section 6418. On the one hand, as the NPRM points out, eligible entities may only make the elective payment election for credits "determined with respect to" such entity under section 6417(a). On the other hand, under section 6418(a), the transferee taxpayer "shall be treated as the taxpayer" with respect to a transferred credit. The question of integrating these two statutes is whether a transferee taxpayer may therefore be "treated as the taxpayer" with respect to whom such credits were determined, for the purpose of applying section 6417(a).

It is consistent with the text and the proposed rules under section 6418 to treat the transferee as stepping into the shoes of the taxpayer transferring the credit. Section 6418 provides that the transferee shall be treated as the taxpayer "for purposes of this title," i.e. all of the Code. The proposed regulations under section 6418 provide an important exception to this general rule: the transferee does *not* apply rules that determine the amount of the underlying credit, such as rules in section 49 or 50(b). It would not make sense to have the transferee re-apply rules that the transferor already applied to determine the amount of eligible credit to be transferred. But this is the only exception provided. By contrast, the rule in section 6417(a) is not a rule about determining the amount of underlying credit. Rather, it is a rule about the tax treatment of the credit (i.e., treating the taxpayer as making a payment against tax). Just as the transferee taxpayer is treated as the taxpayer for the purpose of other rules that relate to the

overall tax treatment of an eligible credit (such as the rules in section 38 or 469), so too should the transferee be treated as the taxpayer for the purpose of section 6417(a).

C. Concerns around the implementation of chaining can be addressed.

The preamble to the proposed rule notes several possible concerns about linking together sections 6417 and 6418 due to differences between them. In our view, each of these concerns can be resolved by following the more restrictive of the two laws when they come into conflict. First, stakeholders noted that taxpayers electing to be treated as applicable entities with respect to section 45V, 45Q, or 45X credits make an election that lasts four years, while the duration of the section 6418 transfer election is limited to the tax year. The Secretary could either limit the 45V, 45Q, and 45X elective pay elections to one year in cases of transfer, or could allow these elections to last up to four years if the transferor renews the transfer election each successive year.

Second, stakeholders note that allowing a partnership or S corporation to make an elective pay election with respect to transferred credits would conflict with the rule that partnerships and S corporations may only claim elective pay on property held directly by the partnership or S corporation. But the real significance of that rule is that partnerships and S corporations may not claim elective pay on property held directly by partners or shareholders, a condition that would not be violated here. If the Secretary agrees that the transferee taxpayer “shall be treated as the taxpayer” with respect to whom the credits were determined, then the case of partnerships or S corporations is not any different from the general rule recommended here.

Third, stakeholders note various rules in section 6417 pertaining to placed-in-service dates of property eligible for elective pay, whereas there are no such restrictions in section 6418. Our proposed solution is to follow the more restrictive statute and only allow chained payments for property that meets the placed-in-service restrictions of section 6417.

Fourth, stakeholders contended that section 6417(d)(3)(ii)'s requirement that a section 6417(a) election be “irrevocable” would seem to prohibit an applicable entity from making a section 6417(a) election with respect to any transferred credit for which the 6417(a) election spans more than one year, because elections to transfer all or a portion of eligible credits under section 6418(a) are annual. We think the proper interpretation is that “irrevocable” only modifies the election made with respect to the credit received by the transferee taxpayer in a given year. Making an irrevocable 6417(a) election for the credit transferred does not force the transferor to make additional transfers in subsequent years.

Fifth, stakeholders noted that a transferee may purchase only a portion of a credit under section 6418(a), which they argued is inconsistent with the requirement under section 6417(a) that the elective payment election be with respect to the entire applicable credit. We think the most logical order of operations is that the transfer is treated as occurring first and the elective payment election with respect to the transferred credit is treated as occurring second. Therefore, if the transferee makes an elective

payment election, it must do so with respect to the *entire credit that was transferred*, but this does not mean that it must purchase the entire credit that was originally earned by the transferor.

If the Secretary is convinced by the legal possibility of chaining but remains concerned about the practical implications of allowing it in all circumstances, the Secretary could consider a set of exceptions to a general limitation on chaining for specific entities. If the option to claim elective payment on credits received by transfer is to be available to any entities, governmental entities should have the highest priority: States, political subdivisions, tribal governments, the Tennessee Valley Authority, and any other federal entities treated as applicable entities. Public entities: are most likely to be aligned with the goals of the Inflation Reduction Act vis-à-vis facilitating the rapid deployment of clean energy; have the fiscal and administrative capacity to support credit-generating projects; and are subject to political oversight so as to alleviate concerns about misuse of chaining.

Alternatively, an even narrower exception would be to limit chaining to public and tax-exempt financing entities, such as public and quasi-public green banks. These entities are best positioned to invest in green, credit-generating projects rather than develop and own such projects themselves. Chaining is necessary to put these entities on a level playing field with private financial institutions, which can purchase credits under section 6418 and take them into account against tax liability. For public and tax-exempt financing entities, chaining is only the way to participate in helping tax-constrained businesses monetize their credits.

To prevent abuses, chaining-eligible transferees should be required to pay at least ninety percent of the value of the credits transferred in order to claim elective payments on such credits. To promote due diligence of transferred credits, the transferee entity should be subject to the same "excessive credit transfer" and "good cause" rules as proposed in § 1.6418–5. Finally, chaining should not be allowed if the transferor and transferee are related parties (within the meaning of section 267(b) or 707(b)).

II. Partnerships and Joint Ventures

A. Treasury and IRS should clarify and expand the types of joint ownership and investment structures that enable participants to claim elective pay.

The NPRM states that an applicable entity must own the property that generates the eligible credit. If a entity does not own a project directly, it could own it through a disregarded entity, own an undivided interest in an ownership arrangement treated as a tenancy-in-common or pursuant to a joint operating arrangement that has properly elected out of subchapter K of chapter 1 of the Code under section 761.

Public entities frequently rely upon joint arrangements to conduct development projects and some typical organizational models utilized by public entities may be not available under the NPRM. The more available partnership or joint ownership structures are clarified and allowed, the easier it will be for public entities to plan projects and develop scalable business models with organizations they intend to work with.

B. Partnerships consisting only of direct-pay eligible partners should be treated as applicable entities for the purposes of elective pay.

Proposed § 1.6417–2(a)(1)(iv) would provide that partnerships and S corporations are not applicable entities described in section 6417(d)(1)(A). We suggest that partnerships and S corporations should be treated as applicable entities in cases where all partners or shareholders are described in section 6417(d)(1)(A). This approach is consistent with the Treasury Department's interpretation that sections 6417(a) & (c) require applying entity-specific rules. As per section 6417(c), a credit should be determined with respect to the partnership or S corporation. But the partnership or S corporation should be treated as an "organization exempt from the tax imposed by subtitle A" when all its partners or shareholders are themselves organizations exempt from tax. Otherwise, there would be no way for a partnership or S corporation to fit within section 6417(d)(1)(A), despite the statute clearly contemplating the inclusion of partnerships and S corporations in section 6417(c)(1). This approach would be consistent with requiring that section 6417 elections be made for an entire applicable credit property.

An important implication of this rule is that partnerships consisting exclusively of applicable entities and their own special purpose vehicles or spin-offs would be treated as applicable entities. Due to restrictions in their charters and in bond covenants, some governmental agencies will need to create special purpose vehicles to undertake credit-generating activities, and to finance those vehicles through a partnership with the agency itself. Even if the Secretary declines to follow our overall recommendation, we suggest allowing this narrow class of partnerships to be treated as applicable entities because, in substance, such a partnership would only reflect the participation of a single applicable entity.

C. Treasury and IRS should provide clarity on eligible co-ownership structures.

We request that the Secretary provide additional examples to illustrate the types of tenancy-in-common and co-ownership structures through which applicable entities can remain eligible for elective pay. In particular, it would be useful to illustrate a range of operating agreements likely to result in exclusion from the operation of subchapter K. Key elements of such fact patterns might include: an agreement to share revenues in proportion with co-owners' respective ownership interests; an agreement to share revenues out of proportion with co-owners' respective ownership interests; an agreement in which rights to dispose of property or take other significant actions are reserved to a subset of the co-owners; and/or an agreement to receive debt financing based on the anticipation of elective pay funds (but where the lender is not a co-owner).

It would also be helpful to clarify the application of Treas. Reg. § 1.761-2(a)(3)(iii) to co-ownership ventures where co-owners generate and sell power as a collective rather than on their separate accounts, or alternatively where the collective entity sells power to each of the participating co-owners and then those co-owners sell power to third parties on their own accounts. In California and some other states,

local government agencies often pool resources under a Joint Powers Authority (JPA).[2] It would be useful to clarify the conditions under which a JPA could be treated as an investing partnership or operating agreement properly electing out of subchapter K, particularly if the JPA is a separate legal entity and sells power under its own account. It would also be useful to clarify whether the participants in a JPA could claim elective pay if they sell power independently rather than through the JPA, but the JPA nonetheless sells some other services or property incidental to the credit-generating activity (and thereby risks running afoul of Treas. Reg. § 1.761-2(a)(3)(iii)).

III. Federal Entities Exempt from Tax

A. Federal agencies are the only major category of non-tax-paying entities whose eligibility for elective pay has not been clarified. Considering their significant development capacities, importance to existing private and public investment, extensive financial resources, and role in the ownership and operation of energy generation, the IRS should confirm the eligibility of federal agencies writ large.

The NPRM did not provide a justification for why federal agencies or instrumentalities have not yet had their eligibility confirmed. No major obstacle to federal eligibility exists that would justify their exclusion considering that state, tribal, and local agencies and instrumentalities are all applicable entities. Considering also that the Tennessee Valley Authority was explicitly included as an applicable entity, excluding other federal or quasi-federal entities from elective pay eligibility would: 1) hamper projects with direct federal involvement or projects that partner with the federal government in some fashion; 2) disadvantage energy investment by institutions with long histories of clean energy development and operation; 3) needlessly limit the ability of federal agencies to meet the Biden-Harris Administration's executive order calling for federal agencies to use their scale and purchasing power to pursue 100 percent carbon pollution-free electricity, net zero emissions from federal procurement, and net zero emissions from overall federal operations.[3]

All of these goals benefit from the utilization of elective pay for tax credits. Elective pay would 1) simplify budgeting for projects in the next 10 years; 2) lower the risk to specific agencies' investments in and bulk purchases of cleaner technologies; 3) cultivate stable demand for (public or private) input and intermediate suppliers, contractors, sellers, and other counterparties the federal government would purchase from as part of elective-pay-driven development while 4) increasing the bargaining power of federal agencies towards contractors by enhancing the government's alternative option of directly owning productive investments; and 5) complement a host of other federal industrial policies and

---

[2] *See* California Government Code Section 6500 et. seq.

[3] White House. 2021. FACT SHEET: President Biden Signs Executive Order Catalyzing America's Clean Energy Economy Through Federal Sustainability. Available at: https://www.whitehouse.gov/briefing-room/statements-releases/2021/12/08/fact-sheet-president-biden-signs-executive-order-catalyzing-americas-clean-energy-economy-through-federal-sustainability/.

investments within the Inflation Reduction Act, Infrastructure Investment and Jobs Act, and the CHIPS and Science Act.

B. Federal agencies should be treated as organizations exempt from tax for the purposes of section 6417.

Agencies and instrumentalities of the federal government should be treated as organizations "exempt from the tax imposed by Subtitle A," and therefore applicable entities per section 6417(d)(1)(A)(i). No Code section explicitly exempts the federal government from tax, but the alternative would be nonsensical. We can reach this conclusion in multiple ways. First, the Code draws the line of tax-exemption at corporate instrumentalities of the United States, which require a specific statutory exemption.[4] The implication is that the United States itself needs no such explicit exemption. Second, the Code specifies that gross income does not include income accruing to states, political subdivisions, or possessions of the United States.[5] Congress appears not to have considered it even worth mentioning the federal government on such a list. Third, the notion of imposing income tax on federal agencies would amount to requiring a transfer of some portion of agency revenue to the Treasury. But absent statutory authorization to the contrary, agency-collected user fees and charges already must be deposited in the Treasury General Fund.[6] In the case of federal Power Marketing Administrations (PMAs), for example, receipts must be deposited into the Treasury.[7] This arrangement illustrates why it does not make sense to speak of federal agencies being taxed.

Individual federal agencies, rather than the United States itself, should be treated as "organizations exempt from tax," with "agency" defined in terms similar to 5 U.S.C. § 551. By including the Tennessee Valley Authority as an applicable entity, the statute already adopts this logic of providing for individual federal agencies and corporations to claim elective pay on their individual behalf. Agencies are demarcated by the boundaries that define an organization, including separate budgets and leadership structures. Further, it would be illogical to treat the United States itself as an applicable entity, because tax credits claimed by the United States would travel from the Treasury General Fund back to the Treasury General Fund: an inconsequential round trip. If tax credits claimed by federal entities are to have any effect, it must be to allocate funds to specific agency budgets rather than to the General Fund.

Treating federal agencies as organizations exempt from tax would raise the practical challenge of asking organizations that do not ordinarily file tax returns to do so. But the statute already embraces this challenge by treating states, municipalities, and the Tennessee Valley Authority as applicable entities. Whatever procedures the Secretary develops to process tax return information from these

---

[4] I.R.C. § 501(c)(1)(A).

[5] I.R.C. § 115.

[6] *See* D. Andrew Austin, *Economics of Federal User Fees*, CONG. RES. SERV. R45463 at 3 (Jan. 22, 2019).

[7] *See, e.g.*, 16 U.S.C. § 832j.

non-traditional taxpayers will be equally applicable to federal agencies in their role as elective pay applicable entities.

If the Secretary is concerned about implementation issues around extending elective pay to all federal agencies, the most urgent subset to make eligible would be the Power Marketing Administrations, the Bureau of Reclamation, and the U.S. Army Corps of Engineers. The Bureau of Reclamation and Army Corps of Engineers own and operate multipurpose federal hydroelectric projects across the country, and the four PMAs market the power provided by these projects. Collectively, these hydroelectric projects amount to 7% of total U.S. power generation.[8] If these federal entities were not applicable entities, and therefore not able to claim elective pay, they would not be able to directly make use of any IRA tax credits, because they lack any income tax liability. Their only option would be to transfer such credits under section 6148. But unlike all other entities that may make use of section 6148, credit transfer would not be a backup plan in the case of insufficient tax liability, but the only option. This would place these federal entities at a strict disadvantage relative to all other energy producers under the IRA. This would be a troubling outcome to impose on entities responsible for a significant share of U.S. power generation and distribution.

Finally, to ensure that the Tennessee Valley Authority is able to retain and make use of elective pay credits it may earn, the Secretary should clarify whether elective pay credits are treated as "proceeds" "from any other activities of the Corporation" under 16 U.S.C. § 831y.

IV. Miscellaneous

The Center for Public Enterprise also seeks clarification from the IRS on the following administrative concerns regarding the implementation of elective pay.

1. **Domestic content requirements.** The IRS should clarify how it intends to administer the domestic content requirement on elective pay eligible credits. In particular, how the IRS will determine the scope of potential exclusions, identify them via the filing and pre-registration processes, and provide certainty to applicable entities on the circumstances under which the requirements are met or not. The domestic content requirements constitute one of the largest sources of uncertainty for potential utilization of elective pay and are already stalling commitments to energy projects by applicable entities. Providing that certainty in clear, unambiguous terms will increase both the takeup of elective pay credits by applicable entities of all kinds and increase the number and diversity of project types that are undertaken. In addition, the IRS should recognize that sufficient markets for domestic inputs may not be available in the initial years of elective pay and incorporate that understanding into its planned administration and the information it publishes.

[8] U.S. Energy Information Administration, "Federal Power Marketing Administrations operate across much of the United States" (Jun. 12, 2013), available at https://www.eia.gov/todayinenergy/detail.php?id=11651.

2. **Prevailing wage and apprenticeship requirements.** Similarly, the IRA should clarify how it intends to administer prevailing wage and apprenticeship requirements on elective pay eligible credits, identify and administer exclusions, and provide certainty to applicable entities on the circumstances under which the requirements are met or not.

3. **The pre-registration process.** The IRS has indicated its plans to provide additional information on the pre-registration process for elective pay in the fall. This pre-registration process should indicate how pre-registration will be required for bulk purchases, such as those of qualified clean commercial vehicles, qualified charging installations, and alternative fuel vehicle refueling property. Do specific transactions each require an elective pay application? Do individual items in a bulk transaction require the applicable entity to pre-register?

4. **Proposed rulemaking on the clean electricity ITC and PTC.** The IRS should announce the expected date for comments on the Clean Electricity Investment Tax Credit and the Clean Electricity Production Tax Credit to further facilitate planning for projects that will not start the development process immediately or expect to be placed in service after 2025. Delays in publishing that guidance will not only limit or slow ongoing project planning, but may prevent applicable entities from opting for claiming elective pay.

5. **Simplified pre-registration and filing.** The IRS should minimize the onerous paperwork and associated filing requirements to pre-register an applicable credit property, file the tax forms necessary to claim elective pay, and to meet various requirements such as domestic content. Given the limited staff and resource capacity among public entities and other applicable entities of all kinds, ensuring a simple process that emphasizes the rapid throughput of elective pay approvals and disbursement would ensure sufficient takeup by applicable entities aiming to invest in clean energy projects.

6. **Late and amended returns.** The IRS should allow applicable entities to claim elective pay on late or amended returns.

7. **Defining "gross receipts" for the zero emission nuclear PTC.** The IRS should clarify how it will define "gross receipts" for the purpose of valuing the Zero Emission Nuclear Power Production Credit. As noted in Center for Public Enterprise's earlier comment submission on elective pay (then direct pay), the definition of "gross receipts" is "ambiguous and potentially introduces biases across nuclear project owners that reflect differences in their contractual arrangements that may undermine the spirit of the provision."[9]

---

[9] Lala, C., P. Williams, Y. Feygin. 2022. *Guidance on the Direct Payment of the Inflation Reduction Act's Clean Energy Tax Credits.* Center for Public Enterprise. Available at: https://www.publicenterprise.org/reports/comments-on-guidance-for-direct-pay.