March 9, 2023

Holly Porter
Associate Chief Counsel
Office of the Chief Counsel
Passthroughs & Special Industries (CC:PSI)
Internal Revenue Service (IRS)
1111 Constitution Avenue, NW Washington, DC 20224

RE: Supplemental Comments on IRS Notice 2022-49 and IRS Notice 2022-50

Ms. Porter,

The National Association of Bond Lawyers ("NABL") appreciates the swift work of the Internal Revenue Service (IRS) and U.S. Department of Treasury to provide guidance pertaining to tax law changes made by the Inflation Reduction Act of 2022 (Pub. L. 117-169). We now wish to provide additional comments, attached, to supplement those made in our November 4, 2022, letter responding to IRS Notice 2022-49, "Request for Comments on Certain Energy Generation Incentives;" and Notice 2022-50, "Request for Comments on Elective Payment of Applicable Credits and Transfer of Certain Credits."[1]

NABL is a nonprofit organization and specialty bar association of approximately 2,500 lawyers whose purposes include, among other things, providing advice and comment at the federal, state, and local levels with respect to legislation affecting state and municipal obligations. NABL believes that participating in the guidance process supports clarification of, and facilitates compliance with, tax laws and regulations. The following comments were prepared by a working group of the NABL Tax Law Committee (whose members are listed in Appendix 1 hereto) and were approved by the NABL Board of Directors.

Thank you in advance for your time and attention on this important matter. I have asked our Director of Governmental Affairs, Brian Egan, to answer any questions you may have.

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[1] See NABL letter to Ms. Holly Porter re: "Response to IRS Notice 2022-49 and IRS Notice 2022-50" sent on November 4, 2022. Web access: https://www.nabl.org/resources/response-to-irs-requests-on-ira-implementation/

You can reach Brian via email at began@nabl.org or via phone at (202) 503-3290. We look forward to hearing from you.

Best,

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NATIONAL ASSOCIATION OF BOND LAWYERS
SUPPLEMENTAL COMMENTS ON
IRS NOTICE 2022-49 AND NOTICE 2022-50

I. Introduction

The Inflation Reduction Act of 2022, Public Law 117-169 (the "IRA"), made a number of changes to the Internal Revenue Code of 1986 (the "Code") relating to the eligibility for, and determination of, tax credits under various production tax credit ("PTC") and investment tax credit ("ITC") provisions, including the addition or modification of sections 45, 45U, 45Y, 48, and 48E.[2] Among these were provisions providing reductions of available credits in circumstances where all or a portion of the credit-eligible facility is financed in whole or in part with tax-exempt bonds.

The IRA also added section 6417, which provides that, in the case of an "applicable entity" (including, e.g., a tax-exempt organization or any State or political subdivision thereof) that makes an election under section 6417 with respect to any of the various PTCs or ITCs determined with respect to such entity, the entity is treated as having made a tax payment equal to the amount of such credit. The electing entity would then be entitled to claim a refund of the deemed payment, thereby effectively permitting the entity to "monetize" the credit.

Finally, the IRA added section 6418, which permits taxpayers not eligible to take advantage of section 6417 to transfer certain credits to third parties in exchange for a cash payment. As in the case of section 6417, section 6418 effectively permits taxpayers that might not otherwise be able to take advantage of these tax credits (e.g., because of a lack of sufficient tax liability to utilize the credit) to monetize them.

In Notices 2022-49 and 2022-50 the IRS requested comments on issues arising under the IRA changes described above. By letter of November 4, 2022, the National Association of Bond Lawyers ("NABL") submitted preliminary comments responding to these notices and undertook to follow up that submission with more detailed comments.[3] The comments below supplement the comments set forth in NABL's November 4 letter.

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[2] All references herein to "section" are to the referenced section of the Code, and all references herein to "Treas. Reg. §" are to the Treasury Regulations as promulgated as of the date hereof.

[3] See NABL letter to Ms. Holly Porter re: "Response to IRS Notice 2022-49 and IRS Notice 2022-50" sent on November 4, 2022. Web access: https://www.nabl.org/resources/response-to-irs-requests-on-ira-implementation/

II. Comments Relating to Reduced Tax Credits When Used in Conjunction with Tax-Exempt Bonds

Determination of the Cost of the Project for PTC purposes.

Unlike the ITC, which is determined on the basis of the cost of the energy property eligible for the credit, historically it has not been necessary specifically to determine the cost of property generating PTCs, which are based on the output of the project. NABL believes that guidance should confirm that the cost determination necessary to calculate the extent of any tax-exempt financing reduction with respect to a PTC facility should be based on criteria and guidance developed in the context of ITCs.

Allocation of Bond Proceeds.

As amended by the IRA, a number of tax credit provisions, including the PTC and ITC for energy projects under sections 45 and 48, contain rules, set forth in section 45(b)(3) (which is cross-referenced by the other tax credit provisions), mandating that those credits be reduced, but not by more than 15%, by a fraction the numerator of which is the portion of the cost of the energy project financed with tax-exempt bonds and the denominator of which is the total cost of the energy project. At the same time, under the tax-exempt bond rules, the allocation of bond proceeds to expenditures is determined under specific rules prescribed for that purpose. See Treas. Reg. §§ 1.141-6 and 1.148-6. NABL believes that the existing rules for allocating tax-exempt bond proceeds should be applied when determining what portion of the cost of an energy project has been financed with tax-exempt bond proceeds.

Under Treas. Reg. § 1.148-6, an issuer may use any reasonable, consistently applied accounting method to account for expenditures of bond proceeds. Reasonable accounting methods for allocating funds from different sources to expenditures for the same governmental purpose include any of the following methods if consistently applied: a specific tracing method; a gross proceeds spent first method; a first-in, first-out method; or a ratable allocation method. An issuer may choose to make a final allocation of bond proceeds to expenditures within the time specified in the Treasury Regulations.

In many cases, issuers will specifically allocate bond proceeds to a particular facility or portion of a facility (a "discrete portion" allocation) or will allocate bond proceeds and other sources to a project on a pro rata basis. Under Treas. Reg. § 1.141-6, for purposes of the private business use rules, an issuer has the option to treat one or more facilities or capital projects (including land, buildings, equipment, or other property), collectively, as an "eligible mixed-used project." Bond proceeds and qualified equity (as defined in the Treasury Regulations) are allocated to the eligible mixed-use project on an undivided portion basis. In each bond year, qualified equity is allocated first to the private business use of the eligible mixed-use project and then to governmental use, and bond proceeds are allocated first to the governmental use and then to private business use, using the percentages of the eligible mixed-use project financed with the respective sources and the percentages of the respective uses.

Based on these principles, NABL requests guidance setting forth the following rules on these matters:

(1) Any allocation of bond proceeds made under sections 141 and 148 can be applied for purposes of the relevant tax credit provisions, including sections 45 and 48, as long as those allocations are applied consistently.

(2) For an energy project that is eligible for PTCs or ITCs and also is part of an eligible mixed-use project under Treas. Reg. § 1.141-6, the issuer may:

(a) treat the energy project as bond-financed (and therefore apply any applicable tax credit reduction), or

(b) treat all or a portion of the energy project as equity-financed if, in each year that the tax credit is claimed, there will be no nonqualified bonds of the issue if qualified equity is allocated to the energy project that is the source of the tax credit eligibility, in addition to any private business use. In effect, during the applicable PTC payout period or ITC recapture period, and solely for purposes of determining whether bond proceeds were used to pay costs of the tax credit-eligible facilities that are part of an eligible mixed-use project, the issuer may treat those facilities for purposes of Treas. Reg. § 1.141-6(b) as if they were facilities used in a private business use.

(3) The continued application of the bond allocation rules after some or all of the available tax credit has been claimed (see the Examples below and the discussion of timing issues in Part III below) will not have a negative impact on any previously claimed tax credit. In other words, after the relevant 5-year recapture period for ITCs and applicable payout period applicable to PTCs (generally 10 years), the issuer no longer needs to apply qualified equity to projects for which a relevant tax credit has been claimed.

We ask the IRS to illustrate the foregoing rules with the following examples. Moreover, if the IRS adopts rules that differ from the ones we have requested, we ask the IRS to illustrate those rules with examples as well.

Examples.

Example 1. Discrete Portion Allocation. Issuer plans a major capital improvement project (the "Project") including office buildings and improvements to its utility system. The improvements to the utility system include the installation of solar power facilities (the "Solar Facilities"). The Solar Facilities are eligible for one or more of the PTCs or ITCs that are "applicable credits" under section 6417(b). The cost of the Solar Facilities is $20,000,000, and the cost of the remainder of the Project is $80,000,000, for a total Project cost of $100,000,000.

The Project is expected to be financed with net proceeds of tax-exempt governmental bonds in the amount of $70,000,000 and qualified equity (as defined in Treas. Reg. § 1.141-6(b)(3)) in

the amount of $30,000,000. For purposes of sections 141 and 148, Issuer allocates $20,000,000 in equity to the Solar Facilities, and $10,000,000 of the equity plus all $70,000,000 of the bond proceeds to the remaining portions of the Project. No bond proceeds are treated as financing the Solar Facilities. Therefore, under the rules of section 45(b)(3), there is no reduction in the amount of the tax credit.

Example 2. Undivided Portion Allocation of Eligible Mixed-Use Project. The facts are the same as *Example 1*, except Issuer elects to treat the entire Project as an eligible mixed-use project within the meaning of Treas. Reg. § 1.141-6(b)(2), and:

a. Issuer enters into an arrangement resulting in 5% (which equals $5,000,000 of the total Project cost) private business use of the Project (unrelated to the Solar Facilities) in each year during the measurement period for the bonds.

   Under Treas. Reg. §1.141-6 (as applied for purposes of section 45(b)(3)), $20,000,000 of the $30,000,000 in equity is allocated to the Solar Facilities, $5,000,000 is allocated to private business use of the Project, and the remaining $5,000,000 of the total $30,000,000 of equity is allocated to governmental use portions of the Project and is available to be allocated to additional private business use arising during the measurement period.

   No bond proceeds are allocated to the Solar Facilities or to private business use. In each year, Issuer treats the Solar Facilities as financed with equity, and, therefore, under the rules of section 45(b)(3), there is no reduction in the amount of the tax credit.

b. The facts are the same as in (a), except that there is 12% ($12,000,000) private business use of the Project (unrelated to the Solar Facilities) in each year during the measurement period for the bonds. Of the $30,000,000 of equity, $20,000,000 is allocated to the Solar Facilities, and the remaining $10,000,000 is allocated to private business use of the Project.

   Thus, $2,000,000 of bond proceeds (which equals $12,000,000 of private business use minus $10,000,000 in equity allocated to that private business use) are allocated to private business use of the Project. Accordingly, $68,000,000 of bond proceeds ($70,000,000 in total bond proceeds minus $2,000,000 of bond proceeds allocated to private business use), are allocated to governmental use of the Project. Therefore, the private business use percentage of the bonds is 2.86% ($2,000,000 divided by $70,000,000), meaning that there are no nonqualified bonds. In each year, Issuer treats the Solar Facilities as financed with the available equity. Under section 45(b)(3), there is no reduction in the amount of the tax credit.

c. The facts are the same as in (b), but in year 3 of the measurement period Issuer enters into a long-term power purchase agreement with a nongovernmental person for 50% of the output of the Solar Facilities. No private business use of the bonds results from this arrangement, because qualified equity has been allocated to the Solar Facilities.

Following the completion of the ITC recapture period or the PTC payout period, as applicable, and in accordance with Treas. Reg. § 1.141-6, qualified equity previously allocated to the Solar Facilities will be available for allocation to private business use of the Project arising thereafter, including the portion of the Solar Facilities that are treated as used in a private business use because Issuer has claimed tax credits with respect to the Solar Facilities, without affecting the previously claimed ITC or PTC.

d. The facts are the same as in (b) and (c), but, under the provisions of Treas. Reg. § 1.141-6, as applied to section 45(b)(3), on the issue date Issuer treats 100% of the Solar Facilities as bond-financed. The available tax credit will be reduced by 15%. All $30,000,000 of qualified equity is available to be allocated to private business use of the Project (including the Solar Facilities).

e. The facts are the same as in (b) and (c), but Issuer treats 10% ($2,000,000) of the Solar Facilities as bond-financed in each year. Under section 45(b)(3), the amount of the tax credit will be reduced by 10%.

f. The facts are the same as in (a), except there is 25% ($25,000,000) private business use of the Project (unrelated to the Solar Facilities) expected during the measurement period for the bonds. The $30,000,000 of qualified equity is not sufficient to cover both the cost of the Solar Facilities ($20,000,000) and the private business use of the Project ($25,000,000). The Solar Facilities cannot be treated as 100% equity-financed, because as a result bond proceeds of $15,000,000 (which equals 21.4% of the $70,000,000 bond issue) would be allocated to private business use, which would result in nonqualified bonds because the bonds would satisfy the private business use and private payment tests. Interest on the bonds therefore cannot be tax-exempt unless (i) all or a sufficient portion of the Solar Facilities are treated as bond-financed (with a corresponding reduction in the amount of the tax credit) so that sufficient equity can be allocated to private business use of the Project, or (ii) Issuer reduces the amount of private business use or increases the amount of qualified equity so that the full amount of the tax credit can be claimed.

g. The facts are the same as in (f) except that, on the issue date, Issuer reasonably expected that there would be no private business use during the measurement period for the bonds. Issuer entered into the arrangement resulting in 25% private business use 3 years after Issuer allocated equity to the Solar Facilities and claimed the full amount of an ITC applicable to the Solar Facilities.

   Issuer may choose to take a remedial action for the bonds under Treas. Reg. § 1.141-12 and continue to claim the full amount of the tax credit, or Issuer may treat the Solar Facilities as bond-financed and repay the IRS for the 15% haircut amount for the ITC.

h. The facts are the same as in (g) except that Issuer had claimed the PTC at the full rate for 3 years after the Solar Facilities were placed in service. After Issuer enters into the arrangement resulting in 25% private business use, Issuer may choose to take remedial action for the bonds under Treas. Reg. § 1.141-12 and retain (in the case of an ITC) or

continue to claim (in the case of a PTC) the full credit, or Issuer may treat the Solar Facilities as bond-financed and repay the IRS for the 15% haircut amount with respect to the ITC or PTC claimed for the first 3 years, and, if claiming the PTC, reduce the available tax credit for each remaining calendar years of the payout period.

Example 3. *Pro Rata Allocation*. Conduit Borrower proposes to finance a portion of the cost of a project that recycles biomass into biogas, which then is further processed into biofuel. The total cost of the project is $300,000,000, of which two-thirds, or $200,000,000, would qualify for financing with tax-exempt bonds (i.e., qualified exempt facility bonds) to be issued by Conduit Issuer, which issues bonds on behalf of County, which is a political subdivision of State. Of the $200,000,000, a portion, costing $100,000,000, is energy property eligible for an ITC. Because of volume cap constraints, Conduit Issuer issues only $100,000,000 of tax-exempt bonds to finance a portion of the costs of the qualifying facilities with the rest of the financing coming from equity. For purposes of sections 142 and 148, Conduit Borrower allocates the bond proceeds ($100,000,000) pro rata to the entire qualified project cost of $200,000,000. Thus, one-half, or 50%, of the cost of the energy property portion of the project is financed with tax-exempt bonds, so the amount of the ITC is reduced by 15%.

Example 4. *Discrete Portion Allocation*. The facts are the same as in *Example 3*, except that the Conduit Borrower allocates all of the bond proceeds to the 50% portion of the project that is not eligible for an ITC. None of the energy project portion of the project is financed with tax-exempt bonds, so there is no reduction of the ITC.

III. Additional Comments Regarding Various Aspects of Tax Credits and Tax-Exempt Bonds

Eligibility Considerations.

Section 6417(d)(1)(A) provides that an "applicable entity" for purposes of electing the benefits of section 6417(a) includes "any organization exempt from the tax imposed by subtitle A," and "any State or political subdivision thereof," together with several other categories of tax-exempt entities. Section 6417(d)(3)(A)(i)(I), which sets forth the deadline for making the election under section 6417, refers to "any government, or political subdivision." Given the broad scope of these provisions, the fact that any organization exempt from tax under subtitle A is an "applicable entity", the fact that section 6417 is intended to extend the benefits of tax credits to entities that generally pay no federal income tax, and the fact that Congress gave broad authority to Treasury in section 6417(h) to write regulations or other guidance "as may be necessary to carry out the purposes" of section 6417, we request guidance to confirm that any entity that (i) is legally authorized to issue tax-exempt debt, as confirmed by decades of legal authority developed in the context of section 103, (ii) is a "governmental person" as described in Treas. Reg. § 1.141-1(b), and (iii) is going to acquire ownership for federal income tax purposes of a credit eligible facility, is an "applicable entity." This would include, for example, constituted authorities, on behalf of issuers, separately incorporated entities that are "integral parts" of a State or political subdivision thereof, so-called "63-20 corporations," and the like.

Timing Considerations.

Election Due Date. Section 6417(d)(3)(A) provides that any election under subsection 6417(a) shall be made "not later than (I) in case of any government, or political subdivision, for which no return is required . . . such date as is determined appropriate by the Secretary, or (II) in any other case, the due date (including extensions of time) for the return of tax for the taxable year in which the election is made. . . ." Given the broad scope of discretion granted to the Secretary under this provision, and the overall intent of section 6417, NABL requests guidance on this matter that provides flexible, "user-friendly" rules for making elections under this section. For example:

- An entity electing under section 6417 that is not otherwise required to file annual returns should be permitted to select a tax year that is the same as, or differs from, the entity's accounting fiscal year.

- The guidance should provide a simplified method for extending the filing deadline, comparable to the return extensions available to return filers such as section 501(c)(3) organizations.

- Flexible rules should be provided for filing amended elections.

- Under Treas. Reg. § 1.150-2, bonds may be issued to reimburse previous payments of expenditures for credit-eligible projects up to 18 months after the project is placed in service for tax purposes. This means that a PTC or ITC may be claimed before the planned issuance of bonds has occurred or in circumstances where it is not clear whether bonds will be issued. Guidance should be provided as to the procedure to follow (i) if an expected bond issue does not occur, or (ii) a full credit is claimed and there is a subsequent decision to issue bonds to finance all or part of the credit-eligible facility.

Examples.

Example 1. On November 15, 2022, School District, a political subdivision of State, contracts with Company to provide solar panels on several of School District's building sites. School District intends to claim the ITC under section 48 for the solar panel project. On February 12, 2023, the solar panels are placed in service. Although School District is exempt from paying income tax, School District determines that, for purposes of section 6417(d)(3), June 30 is the end of its tax year. Pursuant to section 6417, on July 1, 2023, School District elects, by filing a claim and requesting payment under procedures established by the Secretary, to have any applicable credit under section 48 be treated as a payment against tax imposed by subtitle A. Under section 6417(d)(3)(A) and section 6417(d)(4), School District's election is timely, and School District is eligible to receive payment of its refundable credit. In addition, School District could have waited and made the election no later than November 15, 2023 (i.e., the due date in 2023 for a tax return for an entity whose tax year ends on June 30). Further, School District could have requested payment at any time on or after July 1, 2023.

Example 2. Assume the facts are the same as *Example 1,* except that the solar panels are purchased by Nonprofit, an organization described in section 501(c)(3), for its own energy production on its buildings and its own usage. Nonprofit's timing eligibility for making an election and requesting payment is the same as School District in Example 1.

Example 3. Public Utility, during spring of 2023, places in service a qualified facility under section 45. Although Public Utility is exempt from paying income tax, Public Utility determines that, for purposes of section 6417(d)(3), December 31 is the end of its tax year. Pursuant to section 6417, Public Utility elects, on January 1, 2024, by filing a return and requesting payment under procedures established by the Secretary, to have any applicable credit under section 45 be treated as a payment against tax imposed by Subtitle A. Under sections 6417(d)(3)(A) and 6417(d)(4), Public Utility's election is timely, and Public Utility is eligible to begin receiving its refundable credit. Public Utility may receive its annual refundable credit, pursuant to section 45, applicable to the credit period, by filing an annual return and requesting payment, as the Secretary has so provided, on or after January 1 of each year during the applicable period under section 45.

Tax Character of Payments Under Sections 6417 and 6418.

Section 3.3 of Notice 2009-26, which provided guidance relating to the issuance of Build America Bonds (Direct Pay), provided that "in general, the refundable credits for Build America Bonds under section 6431 are payments that are treated as overpayments of tax." NABL asks the IRS to apply the same principles to refunds of the deemed tax payments provided by section 6417. In other words, conceptually, the refund of the deemed payment is a return of the issuer's funds. Accordingly:

- Guidance should confirm that tax credit "refunds" attributable to tax-exempt bond financed property under section 6417 are not treated as gross proceeds of the bonds (e.g., as either replacement proceeds or disposition proceeds of the bonds). Specifically, guidance should provide that payments received under section 6417 have no nexus to a bond issue unless the payments are applied in a manner that results in replacement proceeds of the bond issue under section 148 (e.g., by pledging the payments received to pay debt service on the bonds). Furthermore, Congress intended to treat the monetization of the tax credits under section 6417 as a non-taxable event. Thus, for example, Congress has required that the cash consideration paid in exchange for the tax credits under section 6418 is neither taxable to the payee nor deductible to the payor. By analogy, the direct payment under section 6417 should not be treated as gross proceeds of the bonds.

- Guidance should confirm that any tax credit payments pledged as a source of repayment for tax-advantaged bonds will not result in a "federal guarantee" within the meaning of section 149.

<u>Effect of Basis Reduction Rule</u>.

Section 6417(g) provides as follows:

> (g) Basis reduction and recapture. Except as otherwise provided in subsection (c)(2)(A) [*sic – apparently this is intended as a reference to section 6417(d)(2)(A)*], rules similar to the rules of section 50 shall apply for purposes of this section.

Section 50(c) provides that, in the case of any ITC allowed for energy property, the cost basis of the property will be reduced by an amount equal to 50% of the tax credit taken into account. Consistent with the concept developed in Notice 2009-26, discussed above, guidance should confirm that this reduction should not be treated as a reduction of the cost of the financed assets and thus does not affect the determination of the allocation of bond proceeds.

Appendix 1
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