ELFA
EQUIPMENT LEASING AND
FINANCE ASSOCIATION

November 4, 2022

Internal Revenue Service
CC:PA:LPD:PR (Notices 2022-46, 2022-49, 2022-50, & 2022-51)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Comments Submitted Electronically

To Whom It May Concern:

On behalf of the Equipment Leasing and Finance Association, I am pleased to submit the following comments regarding Notices 2022-46, 2022-49, 2022-50, and 2022-51. To the extent that these comments are applicable or helpful to the Treasury Department or the Internal Revenue Service (IRS) in other parts of its work implementing the Inflation Reduction Act of 2022, we would request that these comments be applied accordingly, and ELFA stands ready to assist with any technical matters that we may be helpful in resolving.

Lease-Pass Through Election

A pass-through lease is a long-standing mechanism that enables a lessor of an investment tax credit-eligible asset to make an election to pass through the tax credit to the lessee of the asset. Under the Inflation Reduction Act of 2022 (the "IRA"), ELFA believes that the lease pass-through election of section 50(d)(5)[1] should be able to be combined with a direct payment election, under section 6417, or a transferability election, under section 6418.

a. What is a Lease-Pass Through Election

Section 50(d)(5) provides that, for purposes of computing the investment credit, rules similar to the rules of former section 48(d) apply for purposes of determining the inclusion in gross income required when a lessor elects to treat a lessee as having acquired investment credit property. *See* Treas. Reg. § 1.50-1. The pass-through election permits the lessee to determine its investment tax credit basis using the then-fair market value of the eligible property, rather than basing it on the cost of the eligible property (the tax-basis). *See* § 50(d)(5) (referencing former section 48(d)(1)(A)). The Treasury Department issued a regulation in which it stated that the fair

[1] All references in these comments to a "section" or "§" without identifying the source are to a section of the Internal Revenue Code of 1986, as amended through today's date (the "Code").

market value of such property on the date possession is transferred to the lessee. Treas. Reg. § 1.48-4(c)(2)(i).[2]

This calculation is sanctioned by the Code even though the lessee may have yet to incur any cost regarding the property (that is, to have paid any rent) and irrespective of whether the lessor constructed the project at a cost materially less than the fair market value of a fully operational project.

b. Why was the Lease-Pass Through Election Enacted by Congress in 1962

The lease-pass through election plays an important role in the allocation of capital by businesses of ensuring that a purchaser of an investment tax credit-eligible asset is not advantaged relative to a lessee of such an asset. Legislative history from 1961 states that "the investment credit may be passed on in the case of these leases on the grounds that it is the decision of the lessee which in most cases brings about the demand for the additional investment." Staff of the Joint Comm. on Tax'n, General Explanation of Draft of Revenue Bill of 1961, at 10-11; *see also* H.R. Rep. No. 88-272, Part I, at 35 (1964).

In today's market for renewable energy projects, the following is an example of the application of the lease pass-through election. A lessor (e.g., a solar developer) makes a lease pass-through election to pass the investment tax credit to a corporation[3]. Under the lease pass-through rules, the tax credit is calculated based on the notional fair market, even though neither the lessee nor the lessor paid that amount for the project. If the fair market value of the project is $100x, with the 30 percent investment tax credit, the corporation (i.e., the lessee) should receive a direct payment of $30x rather than $24x (for a project with an actual cost of $80x).

The same question arises if the lessee opts to transfer (i.e., sell the tax credit) to a corporation. The statutory language seems to provide no intent to treat it differently under transferability scenario than if lessee used the investment credit to reduce its federal income tax liability. ELFA believes that to follow this six-decade old provision of the Code, the buyer of the tax credit should be entitled to a $30x tax credit. Transferability should be able to be combined with a lease-pass through election. This is because even though under section 6418(e)(2) only one "transfer" is allowed, the statutory language does not suggest a Congressional intent that the lease-pass through election should also be treated as a transfer. Moreover, the same should apply for the direct payment that is available to tax-exempt entities and in certain other scenarios.

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[2] The guidance for the Treasury Cash Grant Program clarified again that "a lessor who is eligible to receive a Section 1603 payment with respect to a property may elect to pass-through the Section 1603 payment to a lessee. . . Such an election will treat the lessee as having acquired the property for an amount equal to the independently assessed fair market value of the property on the date the property is transferred to the lessee." Treasury Cash Grant Program Guidance (July 2009/Revised March 2010, January 2011, and April 2011).

[3] The same issue arises under section 6417 if a tax-exempt entity leased the project and made a direct payment election.

Three Month Sale-Leaseback Rule

Sale-leasebacks are important commercial transactions that offer financing efficiencies and have been executed for decades. Under the IRA, ELFA believes that a sale-leaseback within three months of a project being originally placed in service should be able to be combined with a section 6418 election. Specifically, guidance is requested to confirm that sale-leasebacks within three months after a project is originally placed in service as permitted under section 50(d)(4) will not cause recapture for purposes of section 50(a) or preclude a 6418 election. In the case of such a sale-leaseback, the buyer-lessor should be treated as the original user of the leased property and allowed to make the election to transfer all or a portion of the investment tax credit under section 6418.

To explain the historical statutory underpinnings of the sale-leaseback rule, section 50(d) provides, in part:

> Rules similar to the rules of the following provisions (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990) shall apply: . . .
>
> (4) Paragraphs (2) and (3) of section 48(b) (relating to special rule for sale-leasebacks).

The referenced prior version of section 48(b) provided, in relevant part:

> (1) In General. – The term "new section 38 property" means section 38 property the original use of which commences with the taxpayer
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> (2) Special Rule for Sale-Leasebacks. – For purposes of the first sentence of paragraph (1) in the case of any section 38 property which –
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> (A) is originally placed in service by a person, and
>
> (B) is sold and leased back by such person, or is leased to such person, within 3 months after the date such property was originally placed in service,
>
> such property shall be treated as originally placed in service not earlier than the date on which such property is used under the leaseback (or lease).

Therefore, a taxpayer who acquires property otherwise eligible for the ITC from a seller who already placed such property in service, and the taxpayer leases the property back to the seller within the three months of the seller having originally placed the property in service, the taxpayer will be treated as the person who originally uses such property (i.e., the buyer). In this vein, the Treasury 1603 Program provided that:

> in a sale-leaseback transaction, the lessee, who is not the owner of the property, may claim the Section 1603 payment, if three conditions are satisfied:
>
> - First, the lessee must be the person who originally placed the property in service.
>
> - Second, the property must be sold and leased back by the lessee, or must be leased to the lessee, within three months after the date the property was originally placed in service.
>
> - Third, the lessee and lessor must not make an election to preclude application of the sale-leaseback rules.[4]

Moreover, Congress's support for the three-month sale-leaseback rule is reflected in section 168(k)(2)(E)(iii) and similar prior iterations of section 168(k) that have been in the Code since 2002 to facilitate the use of bonus deprecation.[5]

ELFA believes that interpreting section 6418 as not prohibiting a sale-leaseback of the investment tax credit eligible projects within three months of it being placed in service will provide no opportunity for abusive churning of projects. However, absent such interpretation, it would impede the use of lease financing which Congress has recognized in the Code for decades as an important tool to encourage capital formation.

Interconnection Costs and Sale-Leasebacks

Section 48(a)(8) provides that for certain energy property amounts paid or incurred for qualified interconnection property may be included in the basis of such energy property. For the interconnection costs to qualify, the ITC eligible project must have a capacity of five megawatts (a/c) or less. The interconnection costs for an eligible project qualify for the ITC even if the project owner pays for the interconnection improvements, but the interconnection improvements are owned by the utility.

An issue that needs clarified is what happens if a developer pays the interconnection costs and then sells the project to a lessor in a sale-leaseback, or a partnership in a tax equity transaction or a buyer in a traditional disposition. If the lessor (or other buyer) includes reimbursement of the seller's interconnection costs in the purchase price, is it deemed to have "incurred" the interconnection costs? To avoid thwarting congressional intent in expanding ITC eligible property to include certain interconnection costs, the answer should be that the ultimate taxpayer's reimbursement of a predecessor owner's payment of such amounts should be sufficient for the taxpayer to be deemed to have incurred the costs. Otherwise, in many transactions, the ITC with respect to such interconnection costs will not stimulate more small renewable energy projects as Congress intended because the ultimate taxpayer will not be able to

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[4] Payments for Specific Energy Property in Lieu of Tax Credits" under the American Recovery and Reinvestment Act of 2009 Program Guidance published by the U.S. Treasury Department and originally issued in July 2009 and revised in March 2010 and April 2011.

[5] *See, e.g.*, Pub. L. 107-147, title I, VI, Sec. 101(a), 613(b), Mar. 9, 2002, 116 Stat. 2.

monetize them and the developer that did incur them will not able to monetize them as it will not place the corresponding renewable energy project into service.

The Ability of Individuals to Buy Tax Credits

ELFA believes that in the interest of sound tax administration the limitation on using tax credits in the passive activity loss rules of section 469 be deemed to apply to any individual that is not otherwise active for section 469 purposes at the time the individual purchases a tax credit from a seller that has made an election under section 6418.[6]

Absent such an application of section 469, there is a risk that individuals could be misled by unscrupulous parties into purchasing tax credits that either do not exist or are purported to be larger in amount than the underlying renewable energy project actually qualifies for. Also, there is a risk of fraudulent individuals claiming more tax credits on their tax returns than they actually purchased. By applying the passive activity loss rules, the purchasers of tax credits would be limited to c-corporations or individuals that actively participate in the underlying renewable energy activity (or pass-through entities composed of a combination of the foregoing). Such limitation would mean that (i) there are fewer eligible tax credit buyers for the IRS to monitor and (ii) the buyers are either c-corporations, which likely have some sophistication and access to qualified professional advisors, or individuals active in the underlying renewable energy activity and thus should have some sophistication about tax credits from such activity.

It could be asserted that section 469(g), which provides for a release of passive tax credits once the taxpayer disposes of its "entire interest in the passive activity," precludes applying the passive activity loss rules to tax credit buyers as such buyers have no interest in the passive activity. That is the buyer of the tax credit does not own an interest in the project (i.e., the passive activity), so the question arises of how to determine when the taxpayer has disposed of its entire interest in the activity. If the Treasury Department and the IRS determine that section 469(g) precludes an application of the passive activity rules to section 6418 transfers, then the Treasury Department and the IRS should at least make a clear statement that it is concerned about non-active individuals purchasing tax credits and will have the IRS implement special disclosure for such purchases and dedicate audit resources to closely scrutinizing such purchasers and the credits purchased.

Section 30D Original Use Requirement

Section 30D(d) contains an original use requirement related to the new qualified plug-in electric drive motor vehicle credit. Specifically, section 30D(d)(1)(A) defines a motor vehicle that is eligible for the section 30D(d) credit where, among other requirements, "the original use of which commences with the taxpayer[.]" Previously, section 168(k) concerning bonus depreciation had a similar original use requirement and the Treasury Department and IRS issued well thought out final regulations related to "Sale-leaseback, syndication, and certain other transactions[.]" See Treasury Department Regulations section 1.168(k)-1(b)(3)(iii) and rules in

[6] Section 469(d)(2) defines passive activity credit as the excess of the sum of all credits otherwise allowable for the taxable year that are attributable to passive activities over the regular tax liability allocable to such activities.

Treasury Department Regulations section 1.168(k)-1(b)(5)(ii) related to Place-in-service date. We suggest that the Treasury Department and IRS apply rules similar to original use requirement of section 168(k) to the original use requirement of section 30D

Clarification of Requirements Pertaining to Selected Energy Credits

ELFA is aware that several other trade associations are intending to comment extensively regarding the Prevailing Wage, Apprenticeship, Domestic Content, and Energy Communities Requirements discussed in the Treasury Department and the IRS's request for comments. ELFA emphasizes the need for clear standards in this area at the onset of the program so that market participants are able to appropriately determine the economics of these transactions without fear of these economics changing midstream of a long-term project because additional guidance is issued at a future date or public enforcement is taken against other participants indicating that they were misinterpreting a rule. The worst-case scenario is that some market participants are aggressively interpreting the rule, while others are being more conservative, leading to a range of prices in the market for deals that are financed not due to competitive factors but solely due to degrees of interpretation of the rules.

Specifically, ELFA requests that the Treasury Department and the IRS err on the side of providing more specificity especially in the following areas:

1. Qualified Apprenticeship Requirement – ELFA is concerned about ambiguity regarding what comprises a good faith effort to comply with the standards set forth in the Act (i.e. documentation, timing, notice requirements, etc.) and whether there will be safe harbors in this regard. ELFA would recommend a time and date stamped submittal in specified form (email, on-line submittal, etc.), should suffice for the good faith effort to request a qualified apprentice from a registered apprenticeship program. Additionally, ELFA believes that an automatic reply or any reply by the program within the 5-day stated period that does not contain adequate details for the hiring of an available apprentice should not constitute a response by the agency. Our concern here relates to the timing and the possible delay in commencement of projects due to the administrative burden of the apprenticeship requirement.

2. Domestic Content – Are the domestic content requirements to be applied on a component-by-component basis or a project basis. For example, if one very large and expensive component was made entirely from domestic sources, would that allow several smaller, less expensive, components to be made with entirely foreign sourced materials. Additionally, we would request that the Treasury Department specifically delineate what documentation is appropriate to substantiate the domestic content, e.g., is a manufacturers representations or warranties sufficient or is additional due diligence required.

3. Energy Communities – ELFA would again recommend very clear guidance on which projects will qualify for enhanced credits because they are sited in an energy community. ELFA would recommend that the Treasury Department publish a list of such communities whether that be by zip code, census tract, or other widely available geographic descriptor. Additionally, ELFA would request guidance on how projects that

span from an energy community to an area not so designated, e.g., a facility that exists on both sides of a roadway that is a boundary line for a zip code or census tract.

4. Credit Transfers – If enhanced credits are transferred between taxpayers, ELFA is requesting that clear guidance be issued regarding what documentation will be required to substantiate this transfer.

Wind and Solar Facilities Placed in Service in Low-Income Communities

ELFA recommends that the Treasury Department allow the project developer, the financier, or the owner of the project to submit applications under this program regardless of who is the tax owner of the project. This will reduce barriers to entry by allowing entities with experience in the application process to handle that aspect of the program even if they are not the tax owner. This should also assist in the effective administration of the program by the Treasury Department because the applications are likely to be more consistent if the program participant with the most experience in the program is the entity submitting the application.

Background on ELFA and the Equipment Leasing and Finance Industry

ELFA is the trade association representing financial services companies and manufacturers in the more than $1 trillion U.S. equipment finance sector. Equipment finance not only contributes to businesses' success, but to U.S. economic growth, manufacturing, and jobs. Nearly 8 in 10 U.S. companies (79%) use some form of financing when acquiring equipment, including loans, leases, and lines of credit (excluding credit cards). Each year American businesses, nonprofits, and government agencies invest $2 trillion in plant, equipment, and software. Approximately 57%, or $1.16 trillion of that investment, is financed through loans, leases, and lines of credit. America's equipment finance companies are the source of such financing, providing access to capital.

ELFA represents more than 575 member companies, including many of the nation's largest financial services companies and manufacturers and their associated service providers, as well as regional and community banks and independent, medium, and small finance companies throughout the country. ELFA member companies finance the acquisition of all types of capital equipment and software, including agricultural equipment; IT equipment and software; aircraft; manufacturing and mining machinery; rail cars and rolling stock; vessels and containers; trucks and transportation equipment; construction and off-road equipment; business, retail, and office equipment; and medical technology and equipment. The customers of ELFA members range from Fortune 100 companies to small and medium sized enterprises to governments and nonprofits.

ELFA represents virtually all sectors of the equipment finance market and its members see virtually every type of equipment financing transaction conducted in the United States and every type of funding available to providers of equipment finance. ELFA members who are service providers to the equipment finance industry (such as lawyers, accountants, trustees, and vendors) have a unique vantage point of seeing scores of financial transactions from initial concept to final payout and from the perspective of both the borrower/issuer and lender/investor/funding source. ELFA truly is at the heart of equipment finance in the United States and our member companies provide lease, debt, and equity funding to companies of all sizes.

Thank you for the opportunity to provide these comments. Should you have any questions regarding this submission, please address them to Andy Fishburn, ELFA's Vice President of Federal Government Relations, at afishburn@elfaonline.org.

Sincerely,

Ralph Petta
President and CEO