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Internal Revenue Service
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Room 5203
P.O. Box 7604
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Washington, DC 20044

Comments Submitted Electronically

To Whom It May Concern:

The Equipment Leasing and Finance Association (ELFA) is the trade association that represents companies in the $1 trillion equipment finance sector, which includes financial services companies and manufacturers engaged in financing capital goods. ELFA members are a driving force behind the growth in the commercial equipment finance market and contribute to capital formation in the U.S. and abroad. ELFA's nearly 600 members include independent and captive leasing and finance companies, banks, financial services corporations, brokers, investment banks, manufacturers, and service providers.

In November of 2022, ELFA submitted comments to the Treasury Department regarding Notices 2022-46, 2022-49, 2022-50, and 2022-51. One of the topics our comments covered is how the investment tax credit ("ITC") on interconnection costs for small projects works in a sale-leaseback or any transaction in which the taxpayer that incurred the interconnection costs is different than the taxpayer that claims the ITC.

ELFA believes that the proposed section 48 regulations do not adequately address this comment (and a similar comment made by American Clean Power also made in November of 2022) and in fact made the issue worse when the "three-month sale-leaseback" rule (see below) or the "lease pass-through" rule is combined with ITC on interconnection costs.

As an initial matter, the proposed section 48 regulations need to address how the requirement in the interconnection rule that the "energy property shall include amounts paid or incurred by the taxpayer for qualified interconnection property" operates when one taxpayer pays the interconnection costs, sells the project to another taxpayer and that second taxpayer claims the ITC. For instance, is it sufficient for the second taxpayer to reimburse the first taxpayer for its interconnection costs? Must a portion of the purchase price of the project be specifically identified by the buyer and seller as reimbursement of the seller's interconnection costs? Is the buyer's ITC on the interconnection costs limited to the amount the seller incurred for interconnection costs?

The "three-month sale-leaseback" has applied to the ITC for four decades. *See* Deficit Reduction Act of 1984, Pub. L. 98-369, § 114 (1984). It provides critical flexibility in commercial transactions by allowing a developer to demonstrate that a project operates as intended and then selling it to a lessor, often a relatively passive financial institution, and leasing it back and allowing the lessor to benefit from the ITC.

The "lease pass-through rule" allows for a lessor to elect to pass-through the ITC to a lessee, despite the lessor being the tax owner of the project. "The predecessor of this provision was part of the original enactment of the investment credit [in] 1962. If such an election was made, the original use of the property was deemed to commence with the first lessee if he was the first person to use such property for its intended function." Haddock v. Commissioner, 70 T.C. 511, 514 (1978) (citations and internal quotations omitted).

ELFA's reasoning is as follows:

> Prop. Reg. § 1.48-14(g)(1) says: "For purposes of determining the section 48 credit, energy property includes **amounts paid or incurred by the taxpayer for qualified interconnection property** (as defined in paragraph g)(2) of this section".
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> Prop. Reg. § 1.48-14(g)(2) says "The term qualified interconnection property means, with respect to an energy project that is not a microgrid controller, any tangible property that is part of an addition, modification, or upgrade to a transmission or distribution system that is required at or beyond the point at which the energy project interconnects to such transmission or distribution system in order to accommodate such interconnection; is either constructed, reconstructed, or erected by the taxpayer, (as defined in §1.48-9(b)(1)), or for which the cost with respect to the construction, reconstruction, or erection of such property **is paid or incurred by such taxpayer**; and **the original use** (as defined in §1.48-9(b)(3)[*]), of which, **pursuant to an interconnection agreement** (as defined in paragraph (g)(4) of this section), **commences with a utility** (as defined in paragraph (g)(5) of this section)."
>
> Prop. Reg. § 1.48-14(g)(4) says the "term interconnection agreement means **an agreement with a utility** for the purposes of **interconnecting the energy property owned by such taxpayer** to the transmission or distribution system of the utility."
>
> *Prop. Reg. § 1.48-9(b)(3) says "*Original use of energy property*—(i) *In general*. The term *original use of energy property* means the first use to which a unit of energy property is put, whether or not such use is by the taxpayer."

The "taxpayer" in the case of the three-month sale-leaseback rule is the lessor; however, the *taxpayer* would not own the energy property when the original use of the energy property commences with the utility, so the definition of "interconnection agreement" would not arguably be satisfied because the seller/lessee would own the energy property when the utility's original

use of the interconnection property starts. If this were to be the correct interpretation of the proposed regulation, it would effectively deny companies using the three-month sale-leaseback rule from claiming ITCs on interconnection costs.

The three-month sale-leaseback rule is in section 50(d)(4) references old section 48(b)(3) as it read in 1990. It said "Special rule for energy property.—The principles of paragraph (2) shall be applicable in determining the original use of property commences with the taxpayer". Old section 48(b)(2)(B) read in 1990 "is sold and leased by such person, or is leased to such person, within 3 months after 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)".

To address this oversight with respect to the three-month sale-leaseback rule, ELFA believes that the proposed rule in § 1.48-14(g)(2) should be revised to provide "and the original use (as defined in §1.48-9(b)(3) and as applicable taking into account the principles of section 50(d)(4) with such original use determined on the date of the sale-leaseback or lease)".

The "taxpayer" in the case of the lease pass-through rule is the lessee. Therefore, a similar issue arises. The taxpayer does not *own* the energy property as referred to in the definition of interconnection agreement. ELFA recommends the following solution to the lease pass-through rule oversight: the proposed rule in § 1.48-14(g)(4) should be revised to provide the "term interconnection agreement means an agreement with a utility for the purposes of interconnecting the energy property owned (or in the case of the election provided for in section 50(d)(5) leased) by such taxpayer to the transmission or distribution system of the utility." Further, an additional provision needs to be added to the regulations that in the case of section 50(d)(5) election, the lessee will be deemed to have incurred the interconnection costs.

ELFA would also note that at least two previous comment letters requested interconnection costs and transactions in which the project is sold after such interconnection costs were incurred, and we believe that this issue has not been adequately addressed to date. Leasing transactions are an important mechanism for financing equipment under these provisions and this guidance is in the best interest of the Treasury Department, the Service, and taxpayers to ensure smooth functioning of the code and for the envisioned levels of investment to be met.

ELFA stands ready to engage with the Treasury Department and the Internal Revenue Service on these matters. Should you have any questions or with to discuss these matters further please contact Andy Fishburn, ELFA's Vice President of Federal Government Relations, at afishburn@elfaonline.org

Respectfully submitted,

Andy Fishburn
Vice President of Federal Government Relations