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August 14, 2023

*Via Federal eRulemaking Portal at www.regulations.gov*

Internal Revenue Service
CC:PA:LPD:PR (REG-101607-23; REG-101610-23), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments of Carbon Capture Coalition to REG-101607-23: Section 6417 Elective Payment of Applicable Credits; REG-101610-23: Section 6418 Transfer of Certain Credits;[1] and TD 9975: Pre-Filing Registration Requirements for Certain Tax Credit Elections.

To Whom It May Concern:

We write, on behalf of our client the Carbon Capture Coalition, to submit comments in response to the proposed regulations and request for comments published in the Federal Register by the Department of Treasury (Treasury) and Internal Revenue Service (IRS) on June 21, 2023, related to the direct pay election and transfer of certain tax credits.[2] In addition, the Carbon Capture Coalition has provided comments on the pre-filing registration requirements for certain tax credit elections.[3] We appreciate the work of the staff at Treasury and the IRS to issue these proposed and temporary regulations to implement the Inflation Reduction Act's (IRA) direct pay and transferability provisions that will facilitate much-needed investment in carbon capture technology.

The Carbon Capture Coalition is a nonpartisan collaboration of more than 100 companies, labor unions, and conservation and environmental policy organizations, building federal policy support to enable economy-wide, commercial-scale deployment of carbon management technologies to meet midcentury climate goals, strengthen and decarbonize domestic energy, industrial production, and manufacturing, while at the same time retaining and expanding a high-wage jobs base.

We appreciate your consideration of the recommendations discussed in the attached letter. If you have any questions, please do not hesitate to contact us at: N. Hunter Johnston,

[1] We have submitted this comment letter in both of the section 6417 and 6418 dockets on regulations.gov.

[2] 88 Fed. Reg. 40,528 (Jun. 21, 2023) (Section 6417 Elective Payment of Applicable Credits); 88 Fed. Reg. 40,496 (Jun. 21, 2023) (Section 6418 Transfer of Certain Credits).

[3] 88 Fed. Reg. 40,086 (Jun. 21, 2023) (Pre-Filing Registration Requirements for Certain Tax Credit Elections).

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Sincerely,

N. Hunter Johnston

cc: Hon. Lily Batchelder, Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Shelley de Alth Leonard, Deputy Tax Legislative Counsel, Department of the Treasury
Kimberly A. Wojcik, Attorney-Advisor, Department of the Treasury
Jennifer C. Bernardini, Attorney-Advisor, Department of the Treasury
Sarah R. Haradon, Attorney-Advisor, Department of the Treasury
Jacob Goldin, Office of Tax Policy, Department of the Treasury
William M. Paul, Principal Deputy Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service
Holly Porter, Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service
David A. Selig, Senior Counsel (Passthroughs & Special Industries), Internal Revenue Service
Maggie Stehn, Attorney (Passthroughs & Special Industries), Internal Revenue Service
Brad Crabtree, Assistant Secretary for Carbon Management and Fossil Energy, Department of Energy
Noah Deich, Deputy Assistant Secretary Office of Carbon Management, Department of Energy

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Re: REG-101607-23: Comments on Section 6417 Elective Payment of Applicable Credits; REG-101610-23: Comments on Section 6418 Transfer of Certain Credits; and TD 9975: Comments on Pre-Filing Registration Requirements for Certain Tax Credit Elections.

To Whom It May Concern:

We write to provide comments in response to a series of proposed and temporary regulations issued by the Department of Treasury (Treasury) and the Internal Revenue Service (IRS) (hereinafter collectively referred to as Treasury) detailing eligibility and registration for the direct pay election under section 6417 and the transferability election under section 6418. We appreciate the opportunity to provide comments as Treasury works to finalize these critical regulations to implement key provisions of the Inflation Reduction Act (IRA) that will increase the use of the section 45Q credit, reduce transaction costs, incentivize new carbon capture technology, and support good-paying jobs.

The Carbon Capture Coalition (the Coalition) is a nonpartisan collaboration of more than 100 companies, labor unions, and conservation and environmental policy organizations, building federal policy support to enable economy-wide, commercial-scale deployment of carbon management technologies to meet midcentury climate goals, strengthen and decarbonize domestic energy, industrial production, and manufacturing, while at the same time retaining and expanding a high-wage jobs base.

Since the inception of the federal section 45Q tax credit, members of Congress across the political spectrum have increasingly recognized the credit's essential value in bolstering the economy-wide adoption of carbon management technologies to address our changing climate. This includes support for the full value chain of carbon management technologies, carbon capture, removal, transport, utilization, and storage.

Now that the framework for the section 45Q tax credit is in-place through final regulations established in 2021, the Coalition anticipates that project developers can rely on these rules to provide certainty for their projects moving forward.[1] However, many aspects of the IRA's tax credit enhancements to section 45Q will have a

[1] *See* 86 Fed. Reg. 4,728 (Jan. 15, 2021).

significant impact on the development of the still nascent carbon management industry. As in previous comments, the Coalition urges Treasury to promptly issue guidance for the enhanced section 45Q tax credit to ensure flexibility and financial certainty for carbon management project deployment, as intended by Congress.

We appreciate your consideration of the recommendations discussed below and look forward to the issuance of final regulations that will facilitate much-needed investment in carbon capture equipment to reduce greenhouse gas emissions and reach our climate targets.

## I. Executive Summary

The Coalition's membership worked collaboratively to develop the following consensus recommendation to implement the direct pay provisions under section 6417 and transferability provisions under section 6418:

With respect to direct pay elections:

- Final regulations should allow for an annualization principle to apply to direct pay elections so taxpayers can receive direct pay for a full 5-year window and prevent unnecessary project delays.

- Final regulations should address direct pay timing issues and allow taxpayers to claim direct pay against estimated taxes. At a minimum, the final regulations should waive estimated tax penalties related to a direct pay election. The final regulations should allow taxpayers to claim as direct pay only a partial amount of an applicable credit.

- Final regulations should allow taxpayers to whom a credit is attributable under section 45Q(f)(3)(B) to make a direct pay or transferability election. The Coalition recommends Treasury re-evaluate Prop. Treas. Reg. § 1.6417-2(c)(4) to the extent it disallows a direct pay election for a credit transferred pursuant to section 45Q(f)(3) and Prop. Treas. Reg. § 1.6417-2(c)(5)(iv) (Example 4).

- The Coalition recommends that Treasury revise the proposed regulations to confirm that the tax credit eligible for direct pay is treated as a "payment" and that other credits not eligible for direct pay, to the extent available, are to be used to reach the section 38(c) general business credit limit, and credits eligible for direct pay can be used to generate a refund.

- Final regulations should clarify the amount of the section 45Q credit is not reduced by tax-exempt bonds used to finance transportation and storage equipment that is not owned by the taxpayer.

With respect to direct pay and transferability pre-registration:

- Final regulations should streamline the registration process by clarifying the definition of a facility and clarify that taxpayers do not need to provide full documentation for annual registrations if the facts from the previous taxable year are unchanged.

With respect to transferability elections:

- Final regulations should affirm that the scope of section 6418(b) is limited only to the consideration transferred among the parties for the value of the tax credit for a transferability election and affirm that taxpayers can deduct transaction costs related to a transferability election as ordinary and necessary business expenses.

## II. Final regulations should affirm Taxpayers can claim direct pay for five full years.

Under section 6417,[2] once a direct pay election is made for section 45Q, the taxpayer will be eligible to receive a direct payment in the taxable year the election is made and the subsequent four taxable years.[3] Prop. Treas. Reg. § 1.6417-3(e)(3) applies the direct pay election period to consist of the taxable year in which the election is made and each of the four subsequent taxable years.

This reference to "taxable year" suggests that, unless the carbon capture equipment eligible under section 45Q is fully operational on the first day of the taxpayer's taxable year in which it elects direct pay, the taxpayer will only be able to claim direct pay for a pro-rata portion of the first year that the project has been placed in service. The proposed regulations could incentivize taxpayers to delay projects to place them in service on January 1 of the next calendar year to obtain the value of direct pay for a full year. Such an incentive would not only run contrary to IRA's intent to incentivize the rapid deployment of clean energy technology but could add new costs for project developers as they would perform additional economic analysis on the cost of delays compared to the cost of forgoing tax credits.

Congress intended the direct pay provisions to benefit taxpayers by providing an efficient method to maximize the full-value of clean energy tax credits for five years. Depending on the placed in service date for a project, a taxpayer may have a short taxable year or an operating period of less than a year in the first taxable year of operation. Final regulations should allow a taxpayer to claim direct pay for the full amount of tax credits generated during the five-year period. This could best be

[2] Unless indicated otherwise, all "section" references are to the Internal Revenue Code of 1986, as amended (the Code), and all "Treas. Reg. §" or "Prop. Treas. Reg. §" references are to the Treasury regulations or proposed Treasury regulations, respectively, published under the Code.

[3] Section 6417(d)(3)(C)(i)(II).

accomplished by permitting taxpayers to elect direct pay for credits generated during a 60-month period (which would include the short operating period in the first taxable year and claim any remaining time period up to 60 months thereafter). By enacting a 60-month rule, Treasury would align the direct pay regulations with the intention of Congress to allow taxpayers to maximize the value of a tax credit for a full 5 years of direct pay.

If Treasury is unable to issue a 60-month rule, Treasury could achieve similar results by relying on an annualization concept to align the regulations with Congressional intent. Treasury has relied on annualization principles in other areas that are instructive for this purpose. For the purposes of the base erosion and anti-abuse (BEAT) tax under section 59A, the final BEAT regulations provided additional rules relying on annualization principles for when a taxpayer has a tax year of less than 12 months (short tax year). When applying the gross-receipts test and base-erosion test when a taxpayer has a short tax year, the taxpayer must annualize its items by multiplying the total amount for the short tax year by 365 and dividing the result by the number of days in the short tax year.[4]

Thus, as an alternative to a 60-month rule, the Coalition requests Treasury issue final regulations that would allow for an annualization principle to apply to direct pay so that project developers can receive direct pay for a full 5-year window.

## III. Final regulations should address direct pay timing issues and allow taxpayers to claim direct pay against estimated tax payments.

### A. Final regulations should allow taxpayers to claim direct pay against estimated tax payments

Section 6417(d)(3)(A)(i)(I) and Prop. Treas. Reg. § 1.6417-2(b)(1)(ii) provide that the direct pay election must be made no later than the due date (including extensions) for the tax return for the taxable year for which the election is made. Section 6417(d)(4)(B) and Prop. Treas. Reg. § 1.6417-2(d)(2)(i)-(ii) provide that the direct payment will be treated as made on the later of the due date of the tax return for the taxable year or the date on which such return is filed (hereinafter referred to as the "deemed payment date").

The Coalition requests that the final regulations allow eligible taxpayers to file and claim direct pay elections under section 6417 as quickly as possible. Final regulations should permit taxpayers to make a direct pay election in connection with filing quarterly estimated taxes. By preventing taxpayers from making a direct pay election against estimated tax payments, the proposed regulations are delaying the time period that the project developer is able to fully utilize the benefits of the credit. Allowing taxpayers to elect direct pay against estimated payments will align direct pay mechanics under section 6417 with the realities of clean energy project development to provide a

[4] Treas. Reg. § 1.59A-2(c)(5); *see also* 85 Fed. Reg. 64,346, 64,348 (Oct. 9, 2020).

stream of funding during project development rather than the project developer waiting until after a tax return is filed.

Allowing taxpayers to elect direct pay against their estimated tax payments is also critical to continue to drive clean energy innovation. Large and established clean energy companies with significant balance sheets would be less impacted by the proposed regulations and would be able to survive the potential lag between the direct pay election and when the direct payment is received. Smaller companies and start-ups that lead a majority of new clean energy technology development could be detracted from participating in carbon capture and other clean energy technology development if the direct pay mechanism only allows a payment after a return is filed.

In some instances, there could be as long as a 2-year wait time from generating the credit to receiving the direct payment. For example, if a calendar year taxpayer generates a credit eligible for direct pay in early 2023, the earliest the taxpayer could elect direct pay would be April 15, 2024. If the taxpayer files an extension, the direct pay election could be as far out as October 15, 2024. After filing the return and electing direct pay, the taxpayer would also incur additional time for processing the payment occurring after the election.

Congress granted Treasury broad authority to issue "such regulations or other guidance as may be necessary to carry out the purposes of this section."[5] Additionally, the direct pay election must be made "no later than" the due date for the tax return, but Treasury could allow such election to be made earlier. Enabling taxpayers to elect direct pay against their quarterly estimated tax payments would advance Congressional intent of encouraging capital to flow quickly to clean energy projects by allowing efficient monetization of applicable credits. Without such a rule, some taxpayers will not realize the fully intended benefit of the section 6417 election and will be at a competitive disadvantage relative to other taxpayers that can bridge the time between the generation of the credit and receiving the direct payment after filing a return.[6]

### B. At a minimum, final regulations should waive estimated tax penalties related to a direct pay election.

While the statute permits direct pay elections to be made quarterly, due to the deemed payment date in Prop. Treas. Reg. § 1.6417-2(d)(2)(i)-(ii), the payments may not be treated as made quarterly. This timing mismatch means that taxpayers with sufficient applicable credits to cover their tax liability for the taxable year, but who also

[5] Section 6417(h).

[6] The Coalition recognizes that Prop. Treas. Reg. § 1.6417-2(e)(2) could mitigate the impact of potential estimated tax penalties. Under Prop. Treas. Reg. § 1.6417-2(e)(2), the taxpayer applies GBCs, including those attributable to applicable credits, against federal income tax liability before treating any unused current year GBC that is attributable to current year applicable credit(s) for which the taxpayer is making an elective payment election as a payment against tax. This appears to have the effect of eliminating a portion of any estimated tax penalties that otherwise may have been imposed on the unreduced federal income tax liability. This feature of Prop. Treas. Reg. § 1.6417-2(e)(2) should be retained.

receive a refund through the section 6417 direct pay election, could be subject to penalties for a failure to pay estimated taxes during such year.

The preamble to the proposed regulations states that the proposed regulations do not contain a rule to allow taxpayers to claim direct pay on estimated taxes because taxpayers can determine, based on their projected tax liability, the correct amount of estimated tax to pay in order to avoid penalties under sections 6654 and 6655.[7] Even though the proposed regulations allow taxpayers to account for estimated tax liabilities, these taxpayers can still be subject to penalties.[8]

Prop. Treas. Reg. § 1.6417-2(e)(3) provides that the full amount of applicable credits for which a direct pay election is made is deemed to have been made for all other purposes of the Code, including for the calculation of any underpayment of any estimated tax under sections 6654 and 6655. If a direct pay election were allowed to be made quarterly, the credits would reduce the estimated tax payments. The taxpayer's return would show a balance due after the estimated payments, but before the direct pay election is considered. The direct pay election would eliminate the taxpayer's balance and create a refund for the credits not used. However, because of the deemed payment date, the taxpayer can still accrue penalties under sections 6654 and 6655. Prop. Treas. Reg. § 1.6417-2(e)(4)(v) (Example 5) confirms that taxpayers may not owe any tax after applying the direct payment but still may be subject to estimated tax penalties because the payment is treated as made at the filing of the return.

Forcing the taxpayer to overpay its estimated taxes in exchange for making a direct pay election is inconsistent with the intent of section 6417 which was designed to allow taxpayers to better monetize the value of their tax credits without relying on costly tax equity structures. Treasury has broad authority under section 6417(h) to issue regulations to implement the direct pay election, as well as authority under section 6655(j) to prescribe regulations necessary to carry out the purposes of the estimated tax penalties. To incentivize the development and deployment of clean energy projects, the final regulations should waive any estimated tax penalties that would accrue as a result of a direct pay election.

### C. Final regulations should permit partial direct pay elections.

The final regulations should allow a taxpayer electing direct pay to designate a portion of any applicable credit to be subject to the direct pay election, with the remaining portion taken into account as a tax credit on the taxpayer's tax return.

There is nothing in the statute that requires the taxpayer to elect the entire amount of an applicable tax credit as a direct pay election. The statute only requires the

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[7] 88 Fed. Reg. 40,528, 40,535 (Jun. 21, 2023); *see also* Prop. Treas. Reg. § 1.6417-2(e)(3).

[8] *See* Prop. Treas. Reg. § 1.6417-2(e)(4)(v) (Example 5).

taxpayer to make the election for each facility.[9] Further, the statutory prohibition that prevents a taxpayer from making a transferability election under section 6418 in the case of a carbon sequestration facility for which a direct pay election is made under section 6417 would not be required if the taxpayer was required to elect direct pay for the entire tax credit because there would be nothing left to transfer.[10]

Partial direct pay elections would provide flexibility in deal structures and project partnerships that promote economic efficiency. Carbon capture and sequestration projects often involve several parties with differing tax profiles. A project developer could improve the financial feasibility of a project by electing direct pay for a portion of the generated credits to fund operations while using the remaining tax credits to offset its partner's tax liabilities.

Treasury has broad authority under the statute to issue regulations regarding the form and manner of the direct pay election to affirm taxpayers make partial direct pay elections.[11]

## IV. Final regulations should allow taxpayers to whom a credit is attributable under section 45Q(f)(3)(B) to make a direct pay or transferability election.

The proposed regulations would prohibit taxpayers from making a direct pay election or transfer election with respect to a section 45Q credit that a taxpayer earns by disposing of, utilizing, or injecting qualified carbon oxide (CO). The proposed regulations treat a taxpayer allowed credits under section 45Q(f)(3)(B) as indistinguishable from a transferee taxpayer under section 6418(a). Taxpayers allowed carbon capture and sequestration credits under section 45Q(f)(3)(B) are distinguishable from transferee taxpayers under section 6418(a). First, they have a definite connection to the disposal, utilization, and injection property and activities giving rise to their section 45Q credits. In contrast, transferee taxpayers under section 6418(a) are not required to have any factual connection to the property and activities giving rise to their transferred credits. Second, transferees of credits under section 6418(a) are "treated as the taxpayer" with respect to the credits; but section 45Q(f)(3)(B) credits are "allowable" directly to the taxpayer who disposes of, utilizes, or uses qualified CO as a tertiary injectant.[12]

Prop. Treas. Reg. § 1.6417-2(c)(4) provides the electing taxpayer making the direct pay election must either own the underlying eligible credit property, or if ownership is not required, otherwise conduct the activities giving rise to the underlying

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[9] Section 6417(d)(3)(C)(i)(I).

[10] *See* section 6417(d)(3)(C)(ii).

[11] *See* section 6417(h).

[12] *Compare* section 6418(a) ("the transferee taxpayer specified in such election (and not the eligible taxpayer) shall be treated as the taxpayer for purposes of this title with respect to such credit (or such portion thereof)") *with* section 45Q(f)(3)(B) (the credit "shall be allowable to the person that disposes of the qualified carbon oxide, utilizes the qualified carbon oxide, or uses the qualified carbon oxide as a tertiary injectant").

eligible credit. Prop. Treas. Reg. § 1.6417-2(c)(4) further states that no direct pay election can be made for a credit "transferred pursuant to section 45Q(f)(3)." Similar to the proposed direct pay regulations, Prop. Treas. Reg. § 1.6418-2(a)(4)(iii) provides that no transfer election is allowed for eligible credits that are not determined with respect to an eligible taxpayer, such as an election under section 45Q(f)(3)(B).

To earn section 45Q credits for carbon capture equipment placed in service after the Bipartisan Budget Act of 2018, the taxpayer must, at a minimum, both (1) capture qualified CO and (2) dispose of the qualified CO in secure geological storage (or utilize the qualified CO).[13] These two activities necessary to claim section 45Q credits involve separate facilities, equipment, and processes. The statute and prior IRS guidance recognize that a single taxpayer may not be in a position to complete both required activities on its own. In this regard, the statute and prior IRS guidance provide taxpayers the flexibility to contract with others to undertake these activities.[14] Further, the statute includes an election pursuant to which the credit shall be allowable to the person that disposes of, utilizes, or uses as a tertiary injectant the qualified CO.[15] Thus, in the case of an election under section 45Q(f)(3)(B), the credit is "allowed" to a person who undertakes one of the activities essential to generating the credit.

Regardless of whether a taxpayer who obtains credits under section 45Q(f)(3) owns carbon capture equipment, or completes the capture, disposal, utilization, or use as a tertiary injectant of qualified CO, the taxpayer has conducted an activity giving rise to the section 45Q credit. Moreover, the statute makes clear that a taxpayer need not own carbon capture equipment to be allowed to claim the credit, so long as the taxpayer undertakes one of the other activities necessary to generate the credit.[16] Such a taxpayer meets the standard in Prop. Treas. Reg. § 1.6417-2(c)(4) of conducting the activities giving rise to the underlying eligible credit or in Prop. Treas. Reg. § 1.6418-2(a)(4)(iii) of having credits "determined" with respect to itself. Thus, in the case of taxpayer who is allowed a credit under section 45Q(f)(3) as a result of being the party disposing or using the carbon oxide, the proposed regulations are not consistent with the standard applied in Prop. Treas. Reg. § 1.6417-2(c)(4) as the disposal and utilization of carbon oxide are activities that give rise to the section 45Q tax credit

[13] Section 45Q(a)(3)-(4).

[14] *See* section 45Q(f)(3)(A)(ii) (owner of carbon capture equipment may contract for the capture, disposal, utilization, or use as a tertiary injectant of qualified CO); *see also* Rev. Rul. 2021-13 (holding that a taxpayer is not required to own every component of carbon capture equipment within a single process train to be the person who may claim the section 45Q credit).

[15] Section 45Q(f)(3)(B).

[16] *See* Section 45Q(f)(3)(A)-(B). Section 45Q(f)(3)(A)(ii) provides the section 45Q credit is available "to the person who owns the carbon capture equipment and physically or contractually ensures the capture and disposal, utilization, or use as a tertiary injectant of such qualified carbon oxide," and section 45Q(f)(3)(B) does not require ownership, but provides that an owner under section 45Q(f)(3)(A)(ii) can make an election under section 45Q(f)(3)(B)(i) to allow the credit to be claimed by the person "that disposes of the qualified carbon oxide, utilizes the qualified carbon oxide, or uses the qualified carbon oxide as a tertiary injectant."

pursuant to section 45Q(a). Prop. Treas. Reg. § 1.6417-2(c)(5) Example 4 reflects this inconsistency.

Section 45Q(f)(3) does not effect a transfer of section 45Q credits. It is an attribution rule that addresses who is allowed the single credit that is generated by taxpayers working together to capture and dispose of qualified CO. In contrast to credit transferees under sections 6418(a) and 50(d)(5), who must be "treated as the taxpayer" that generated the transferred credit in order to claim the credit, credits are "allowable" to credit claimants under section 45Q(f)(3)(B) because they satisfy one of the necessary elements to generate section 45Q credits: ensuring disposal, utilization, or injection of qualified CO. Instead, section 45Q(f)(3) ensures that only one taxpayer satisfying the necessary elements claims the credit.

Accordingly, the Coalition recommends that Treasury re-evaluate Prop. Treas. Reg. § 1.6417-2(c)(4) to the extent it disallows a direct pay election for a credit transferred pursuant to section 45Q(f)(3) and Prop. Treas. Reg. § 1.6417-2(c)(5)(iv) (Example 4). Example 4 states that Taxpayer Q is engaged in the business of capturing carbon and "has section 45Q credits transferred to itself pursuant to section 45Q(f)(3)" and goes on to say that Taxpayer Q cannot make a direct pay election for any credits transferred pursuant to section 45Q(f)(3). This statement in Example 4 is incorrect as Taxpayer Q does not have "section 45Q credits transferred to itself pursuant to Section 45Q(f)(3)." Rather, Taxpayer Q has engaged in an activity necessary under the statute to generate credits and pursuant to an election by another party conducting such an activity, the section 45Q credit is allowed to Taxpayer Q and not the other party.

These clarifications will preserve the original rules, as promulgated by Treasury in 2021, for taxpayers to decide which party engaged in carbon capture activities should be allowed the section 45Q credit, and will better coordinate the purposes of section 45Q and the direct pay and transfer elections under sections 6417 and 6418.[17]

## V. Final regulations should allow other credits not eligible for direct pay to be used to reach the section 38(c) general business credit limit, so that credits eligible for direct pay can be used to generate a refund.

The interaction between the section 38 ordering rules and the proposed regulations potentially frustrates Congressional intent in creating the new monetization mechanisms. Under section 38(c), the amount of the general business credit (GBC) allowable in any tax year generally may not exceed the excess, if any, of the taxpayer's net income tax over the greater of: (1) the tentative minimum tax for the tax year; or (2) 25% of so much of the taxpayer's net regular tax liability as exceeds $25,000. Section 38(d) provides ordering rules for the determination of which credit within the GBC has been used within the limitation described above. Under the ordering rules, credits generally must be used in the order in which they are provided for in section 38(b).

[17] *See* 86 Fed. Reg. 4,728 (Jan. 15, 2021).

Under these ordering rules, if a taxpayer reaches the section 38(c) GBC limit through the use of prior year credit carryforwards and current year credits that are eligible for direct pay are higher in the section 38(b) ordering rule than other credits available to the taxpayer, the taxpayer would lose the ability to avail itself of the direct pay mechanism for direct pay eligible credits – notwithstanding that the taxpayer had other credits, ineligible for direct pay, that could have been used in reaching the section 38 GBC limit. Instead of receiving the benefits of section 6417, the taxpayer would wind up carrying forward these excess GBCs.

For example, consider a taxpayer with a tax liability before GBC utilization of $240, a credit carryforward into the current tax year of $5, a direct pay-eligible section 45Q credit earned in the current tax year of $200, and a direct pay-ineligible section 45Y credit earned in the current tax year of $250. Under the section 38 ordering rules, the taxpayer must utilize the $5 carryforward first. As for the current year credits, the ordering rules provide that the section 45Q credit must be utilized before the section 45Y credit. The taxpayer will reach the section 38(c) limit by use of the section 45Q credit, and must carry forward its section 45Y credit. As a result, the taxpayer will only benefit from the section 45Y credit if the taxpayer has tax liability in the subsequent year which the credit may offset.

Instead, the Coalition recommends that Treasury revise the proposed regulations to provide a two-step approach where the section 38(d) ordering rules are applied separately to direct-pay ineligible credits and to direct-pay eligible credits.[18] Under this approach, direct pay-ineligible credits would first be applied against federal income tax liability using the section 38(d) ordering rules, and then direct pay-eligible credits would be applied second using the section 38(d) ordering rules. This has the effect of preserving, to the greatest extent possible, the treatment of the tax credits that are eligible for direct pay as an unused current year GBC that is treated as a net elective payment amount. The ordering rules should not cause such credits to be included in the GBC limit and applied against tax liability where other lower-ranked tax credits are available to reduce that tax liability, thereby reducing the amount of the eligible credit available for direct payment.

This recommendation is supported by the statutory treatment of the direct pay tax credit as a "payment." Section 6417(a) provides that if an applicable entity makes an election to receive a payment with respect to any "applicable credit," then "such entity shall be treated as making a payment against [income tax] (for the taxable year with respect to which such credit was determined) equal to the amount of such credit" (emphasis added). Prop. Treas. Reg. § 1.6417-2(a)(1) repeats the statutory language and refers to "the amount determined under paragraph (c) of this section." Prop. Treas. Reg. § 1.6417-2(c) addresses certain issues specific to tax-exempt entities (e.g., grants and forgivable loans), as well as general rules and certain limitations for tax-exempt and taxable entities. Neither the statute nor Prop. Treas. Reg. § 1.6417-2(c) say anything about GBCs or the use of the ordering rules under section 38(d). Further, it is notable

[18] This kind of sub-ordering rule is consistent with the approach to "specified credits" under section 38(c)(4)(A).

that Prop. Treas. Reg. § 1.6417-2(b)(5) provides: "An elective payment election applies to the entire amount of applicable credit(s) determined with respect to each applicable credit property that was properly registered for the taxable year, resulting in an elective payment amount that is the entire amount of applicable credit(s) determined with respect to the applicable entity or electing taxpayer for a taxable year" (emphasis added). Thus, under the statute and these portions of the Proposed Regulations, the direct payment is correctly applied – first, as a payment against the taxpayer's federal income tax liability (if any), after applying any GBCs other than the applicable credits for which an elective payment election has been made, and, second, as an excess payment that is refundable to the taxpayer.

This recommendation is also consistent with the purpose of section 6417. As Treasury acknowledges in the preamble to the proposed regulations, "[a]llowing entities without sufficient federal income tax liability to use a business tax credit to instead make an election to receive a refund of any overpayment of taxes created by the elective payment election will increase the incentive for taxpayers to invest in clean energy projects that generate eligible credits because it will increase the amount of cash available to those entities, thereby reducing the amount of financing needed for clean energy projects."[19]

## VI. Final regulations should clarify the amount of the section 45Q credit is not reduced by tax-exempt bonds used to finance transportation and storage equipment that is not owned by the taxpayer.

The section 45Q credit is attributed to either the taxpayer that owns the carbon capture equipment and physically or contractually ensures the capture and disposal, utilization, or use as a tertiary injectant of the qualified carbon dioxide, or the taxpayer that disposes of, utilizes, or uses the CO as a tertiary injectant.[20] Section 45Q(f)(8) provides that the amount of the section 45Q credit is reduced when tax-exempt bonds are used to provide financing and that "rules similar to section 45(b)(3)" apply. Section 45(b)(3) applies this reduction based on the tax-exempt financing "which is used to provide financing for the qualified facility" and can reduce the credit by up to 15 percent.[21]

Final regulations should clarify that the amount of the section 45Q credit is not reduced by tax-exempt bonds that are used to provide financing for equipment or other assets that are not carbon capture equipment, such as transportation and temporary storage. The taxpayer claiming the section 45Q credit generally is not the owner of the equipment necessary for transportation and temporary storage activities under section

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[19] *See* 88 Fed. Reg. at 40,525 (Jun. 21, 2023).

[20] Section 45Q(f)(3)(A)-(B).

[21] *See* Section 45(b)(3)(A)-(B). Projects financed with tax-exempt bonds may have the credit reduced by the lesser of 15 percent or the fraction of the proceeds of a tax-exempt obligation used to provide financing for the qualified facility over the aggregate amount of the qualified facility's financing costs for the taxable year and all prior taxable years.

45Q(f)(3)(A) and (B). These activities are not included in the amount of the section 45Q credit attributed to the taxpayer and, therefore, should not fall within the statutory rule in section 45Q(f)(8). As a result, the amount of the taxpayer's credit should not be reduced by such amount if the transportation and temporary storage activities are financed using tax-exempt bonds and not owned by the taxpayer. The Coalition believes additional guidance regarding this issue would be helpful.

## VII. Final regulations should clarify the definition of a facility for making a direct pay or transferability registration and provide a streamlined pre-registration process.

To implement the direct pay and transferability elections, Treasury also issued temporary regulations that include mandatory information and registration requirements for taxpayers planning to elect direct pay under section 6417 or transferability under section 6418.[22]

### A. Final regulations should streamline the registration process for multiple process trains that are part of a single facility

Under Temp. Treas. Reg. § 1.6417-5T(b)(4) and Temp. Treas. Reg. § 1.6418-4T(b)(4), taxpayers must pre-register with the IRS to obtain a registration number to make a direct pay or transferability election. The temporary regulations require taxpayers to make a separate registration and obtain a separate registration number for each separate "applicable credit property." The temporary regulations require the taxpayer to include the registration number of each applicable credit property on its annual tax return.[23] The temporary regulations further state that the IRS will treat a direct pay election or transferability election as ineffective with respect to an applicable credit property if the taxpayer does not include a valid registration number on its return.[24]

In the case of section 45Q credits, under Prop. Treas. Reg. § 1.6417-1(e)(3), an applicable credit property means a single process train of carbon capture equipment. Under Rev. Rul. 2021-13, a credit claimant need not own all components in a single process train. As a result, under this proposed regulation and the temporary regulations under Temp. Treas. Reg. § 1.6417-5T(b)(4) and Temp. Treas. Reg. § 1.6418-4T(b)(4), a separate pre-registration would be required for each single process train of carbon capture equipment, and owners of separate components in a single process train would need to register.

For taxpayers with multiple process trains that are part of a single facility (or part of a "single project" within the meaning of Treas. Reg. § 1.45Q-2(c)(2)) or multiple owners of separate components in a single process chain, this could require the

[22] *See* 88 Fed. Reg. 40,086 (Jun. 21, 2023).

[23] Temp. Treas. Reg. § 1.6417-5T(c)(4).

[24] *See* Temp. Treas. Reg. § 1.6417-5T(c)(5); Temp. Treas. Reg. § 1.6418-4T(c)(5).

submission of large amounts of duplicative information about each process train, which could make administration and compliance with the registration process difficult.

The final regulations should consider ways in which the pre-registration process can be streamlined for multiple process trains or multiple component owners that are part of a single facility or part of a single project. Treasury has previously determined that a taxpayer can make a single project election for multiple facilities that share certain characteristics. *See* Treas. Reg. § 1.45Q-2(c)(2). A similar rule should be applied here. The Coalition recommends the registration requirements for applicable credit property under sections 6417 and 6418 for the section 45Q credit align with the definition of a "facility" for the purposes of the section 45Q credit. The Coalition submitted comments to Treasury on March 29, 2023, regarding the definition of facility under section 45Q.[25]

### B. Final regulations should clarify that taxpayers do not need to provide full documentation for annual registrations if the facts from the previous taxable year are unchanged.

In addition to obtaining a registration number for each applicable credit property, Temp. Treas. Reg. § 1.6417-5T(c)(2)-(3) and Temp. Treas. Reg. § 1.6418-4T(c)(2)-(3) state that each registration number is only valid for one taxable year and require taxpayers to re-apply and register each year to elect direct pay or transferability elections.

Congress provided Treasury with broad authority to determine the required pre-registration information. Under sections 6417 and 6418, Treasury may require "such information...or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments."[26] Requiring taxpayers to undergo a full registration each year after filing an initial registration, even if the facts from the previous registration have not changed presents additional burdens on the taxpayer without further preventing any duplication, fraud, or improper payments.

The Coalition recommends that the final regulations streamline this registration process to ensure taxpayers can continually rely on the direct pay and transferability provisions. The final regulations should clarify that the annual re-application process does not require taxpayers to provide full documentation, but rather requires asserting to the IRS that the facts from the previous registration have not changed so as not to be overly burdensome. Even if some facts have changed, the final regulations should only require taxpayers to submit documentation of the relevant factual changes rather than re-apply with full documentation.

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[25] *See* IRS-2022-0028-0110 (Comments of Carbon Capture Coalition to Notice 2022-57, Request for Comments on the Credit for Carbon Oxide Sequestration), *available at* https://www.regulations.gov/comment/IRS-2022-0028-0110.

[26] *See* sections 6417(d)(5); 6418(g)(1).

## VIII. Final regulations should affirm that taxpayers can deduct transaction costs related to a transferability election as ordinary and necessary business expenses.

Under section 6418(b) and Prop. Treas. Reg. § 1.6418-2(e)(3), the cash consideration the transferee taxpayer pays to the eligible (transferor) taxpayer in exchange for the transfer of a tax credit is not included in the eligible taxpayer's gross income and is not deductible by the transferee. The scope of both the statute and the proposed regulations is limited only to the consideration received from the sale of the credit.

Neither the statute nor the proposed regulations address (1) the federal income tax treatment of the transaction costs related to a transferability election for either the eligible taxpayer or transferee taxpayer, and (2) whether a transferee taxpayer is permitted to deduct a loss if the amount paid to an eligible taxpayer exceeds the amount of the eligible credit that the transferee taxpayer can ultimately claim.

Under section 162, businesses are allowed to deduct all the ordinary and necessary expenses paid or incurred in a taxable year related to carrying on a trade or business.[27] After 2025, section 212 will allow for a similar deduction for individuals to deduct ordinary and necessary expenses that are incurred in connection with income-producing activities.[28] Section 165 allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.[29]

In response to Treasury's specific request as to the applicability of section 265 or the double benefit principle, we note that neither of those doctrines apply in the section 6418 context.

With respect to section 265, section 6418(c) creates a tax-exempt construct to ensure that amounts that are non-taxable under section 6418 retain that character in connection with a cash distribution from a partnership. Aside from that technical necessity, the statute recognizes that a tax credit is not an item for federal income tax purposes,[30] and accordingly excludes receipts from income while precluding deductions for the amounts paid. The recognition that consideration is not income precludes application of section 265 which is premised upon the existence of tax-exempt income.

Deducting transaction costs also do not give rise to a double benefit. Specifically, the double benefit principle "has been limited to instances in which a taxpayer has

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[27] *See* section 162(a).

[28] *See* section 212(1); *see also* section 67(g). For tax years beginning in 2018 through 2025, the Tax Cuts and Jobs Act suspended a taxpayer's ability to deduct miscellaneous itemized deductions.

[29] *See* section 165(a).

[30] Additional support for this conclusion appears in Treas. Reg. 1.704-1(b)(4)(ii) which provides that a tax credit has no impact to capital accounts in the partnership context, which is premised on the credit not being an item.

attempted to claim the practical equivalent of multiple deductions for the same expense but where Congress didn't intend the result."[31] There is no indication that taxpayers seek to claim more than a single deduction for transaction expenses. Additionally, section 6418 precludes deductions for the amounts paid for the tax credit, thereby foreclosing the possibility of more than one deduction for the transaction expense.

Based on the foregoing, final regulations should affirm that the scope of section 6418(b) is limited only to the consideration transferred among the parties for the value of the tax credit for a transferability election and affirm that section 6418(b) does not override the general rules under sections 162, 212, and 165 that permit the deduction of expenses or losses incurred in a trade or business or in connection with income-producing activities. If the final regulations disallow deductions for transaction expenses related to transfer elections under section 6418, credits that are transferred under section 6418 would yield a different tax posture than under the tax equity transactions permitted without regard to section 6418.

The Coalition looks forward to working with Treasury on these critical issues. If you have any questions regarding this submission, please contact me at jstolark@carboncapturecoalition.org.

Sincerely,

Jessie Stolark
Executive Director
Carbon Capture Coalition

[31] *Charles H. Leyh v. Comm'r,* 157 T.C. 86, 92 (2021).