



## ENCAP INVESTMENTS L.P.

November 11, 2022

SUBMITTED ELECTRONICALLY AND VIA USPS

Internal Revenue Service  
CC:PA:LPD:PR (Notice 2022-50)  
Room 5203  
P.O. Box 7604, Ben Franklin Station  
Washington, D.C. 20044

***Re: Request for Comments on Regulatory Implementation of the Inflation Reduction Act and Sections 6417 and 6418 of the Code Pursuant to Notice 2022-50.***

To Whom It May Concern:

EnCap Investments L.P. (“**EnCap**”) appreciates the opportunity to submit comments regarding the Inflation Reduction Act (“**IRA**”) pursuant to Notice 2022-50.

### **I. BACKGROUND AND EXECUTIVE SUMMARY**

The Treasury Department and the IRS requested comments on any questions arising from Sections 6417 and 6418<sup>1</sup>, as added by the IRA, that should be addressed in guidance.

As discussed in more detail below, we respectfully request clarifying guidance be issued with respect to certain issues applicable to partnerships that have partners some of which are tax-exempt organizations that are classified as “applicable entities” under Section 6417 and some of which are taxable or other persons that are classified as “eligible taxpayers” under Section 6418 (a “**Mixed Partnership**”).

- We would appreciate guidance on how a Mixed Partnership should utilize the new monetization methods afforded by Sections 6417 and 6418. More specifically, guidance as to whether a Mixed Partnership should (i) be treated entirely as an “eligible taxpayer” notwithstanding partial ownership by applicable entities (“**Entity Approach**”) and be afforded the ability to transfer 100% of any eligible credits generated to unrelated taxpayers pursuant to Section 6418(a) (“**Transferability**”), (ii) be treated instead as, in part, an applicable entity in the same proportion as its ownership is held by applicable entities (in which case, the Mixed Partnership could elect for such portion to be treated as making a direct payment against its federal income tax liabilities pursuant to Section 6417(a) (“**Direct Pay**”) and, in part, an eligible taxpayer in the same proportion as its ownership is held by eligible taxpayers (in which case, the Mixed Partnership could elect Transferability for such portion (“**Proportional Ownership Approach**”) and, if so, how to determine proportional ownership by each of the two categories of owners, or (iii) be treated under some other approach.

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<sup>1</sup> Except as otherwise indicated, all “Section” and “Treasury Regulation Section” references contained herein refer to, respectively, sections of the Internal Revenue Code of 1986, as amended (the “**Code**”) and the Treasury Regulations promulgated thereunder.

- Regardless of the approach utilized in the bullet above, guidance confirming that, in the case of investment tax credits (“ITCs”) generated by the Mixed Partnership, the existence of applicable entities as partners will not result in a reduction pursuant to Section 50(b)(3) and (4)(A)(i) to the amount of any ITC for which a Mixed Partnership (or portion thereof) may elect Direct Pay or Transferability.

Direct Pay and Transferability greatly expand the ability to monetize certain tax credits for investors in renewable energy projects and assets that qualify for such tax credits. These new monetization methods have generated significant interest in developing and operating renewable projects by various types of investors—in particular, and the focus of this comment letter, investors with different tax characteristics that invest together in a renewable energy project through a Mixed Partnership. There is concern that investors cannot confidently transact and infuse capital into these projects utilizing these monetization methods until they receive guidance with respect to the proper utilization of these provisions by Mixed Partnerships.

## II. GENERAL COMMENTS

The introduction of the IRA has the potential to change the landscape of renewable energy investment by providing investors with the ability to monetize tax credits in new and useful ways. However, as stated above, to continue to raise capital to facilitate investment after the enactment of the IRA, guidance is needed to address the application of Sections 6417 and 6418 to Mixed Partnerships. Tax-exempt investors often deploy significant amounts of capital in various investment markets and, historically, were not able to directly, or indirectly through partnerships, hold investments that generated ITCs without causing a reduction in the amount of the tax credits available for utilization. However, the IRA’s policy goal of increasing renewable energy investment by introducing Direct Pay to allow tax-exempt investors to benefit from ITCs represents a welcomed, significant and intentional departure from prior law.

A representative factual pattern that is common in renewable project investments is a State Pension Fund that partners with a manager in a partnership to make investments in solar facilities. To illustrate the areas where guidance is needed, assume that this Mixed Partnership, Partnership X, generates \$100 of ITCs in year 1 (determined before the application of Sections 50(b)(3) or (4)(A)(i)). The State Pension Fund provides 90% of the capital for the project with the manager providing 10% of such capital, but, because the manager has the expertise and does develop and operate the facilities, it receives 20% of the profits from the project after the State Pension Fund and the manager receive a return of their respective capital investments. The State Pension Fund and the manager split the remainder of the profits pro rata in accordance with their relative capital investments. Partnership X owns the facilities, and therefore, pursuant to Section 6417(c) and Section 6418(c), is the entity that makes the election for either Direct Pay or Transferability. In applying Sections 6417 and 6418 in this scenario, the following questions arise:

1. Is Partnership X an “applicable entity” under Section 6417 in whole or in part?
  - a. If Partnership X is, in part, an “applicable entity” with respect to the State Pension Fund’s ownership, how is the State Pension Fund’s ownership of Partnership X calculated for this purpose?
  - b. For purposes of this example, assume that guidance provides that Partnership X is determined to be 90% an “applicable entity” and 10% an “eligible taxpayer” and that, as a result, Partnership X elects Direct Pay with respect to \$90 of the ITC. Will the partnership be eligible to transfer the remaining \$10 pursuant to a

Transferability election without any reduction under Sections 50(b)(3) and (4)(A)(i)?

- i. If Sections 50(b)(3) and (4)(A)(i) continue to apply for purposes of Section 6418, Partnership X would experience a reduction in the amount of ITC it could otherwise monetize of 9%.
2. If Partnership X is not an “applicable entity,” even in part, presumably Partnership X should instead be treated fully as an “eligible taxpayer” under Section 6418 that may elect Transferability?
  - a. If Partnership X is considered an “eligible taxpayer” as a whole, should the full \$100 ITC be treated as an “eligible credit” for which Partnership X can make a Transferability election? How will Sections 50(b)(3) and (4)(A)(i) impact the amount of eligible credit for this purpose?
    - i. For example, if Sections 50(b)(3) and (4)(A)(i) continue to apply for purposes of Section 6418, Partnership X would be limited to an eligible credit of \$10, resulting in a 90% reduction in the amount of ITCs Partnership X is able to monetize.<sup>2</sup>
3. In both examples, without treating Sections 50(b)(3) and (4)(A)(i) as inapplicable, Partnership X is adversely impacted solely by virtue of its status as a Mixed Partnership between a tax-exempt investor desiring to invest in the project and an experienced manager who can effectively develop or operate the facilities.
4. Even if Partnership X is treated as, in part, an “applicable entity” and, in part, an “eligible taxpayer,” can Partnership X nonetheless elect to be treated as an “eligible taxpayer” as a whole and transfer the full \$100 of ITC rather than elect partial Direct Pay and partial Transferability with respect to the ITC? Partnership X may prefer this option for administrative ease or other non-tax reasons notwithstanding that a partial election would likely yield the receipt of more cash proceeds.

To further the Congressional goal of incentivizing investment in renewable energy projects, including by tax-exempt entities, we highlight in more detail below the various areas illustrated above in which guidance is needed for investors to appropriately make use of Direct Pay and Transferability in Mixed Partnerships. Our comments emphasize that, regardless of the approach chosen, guidance should confirm that Sections 50(b)(3) and (4)(A)(i) will not apply to reduce an ITC in a Mixed Partnership that seeks Direct Pay or Transferability in whole or part.

**a. Direct Pay – Section 6417<sup>3</sup>**

As described in more detail below, guidance is needed to address the application of Section 6417 to Mixed Partnerships. Partnerships are not currently included in the definition of an “applicable entity” under Section 6417, so guidance is needed to determine whether the partnership will be viewed entirely as an “eligible taxpayer” for purposes of Section 6418 (i.e., the Entity Approach) or as a part “applicable

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<sup>2</sup> See Section 6417(d)(2)(A).

<sup>3</sup> Guidance should clarify that cash received by a partnership as proceeds from a Direct Pay election may be distributed to the partners of the partnership pursuant to the partnership agreement regardless of the allocation of the tax-exempt income from such proceeds.

entity” and a part “eligible taxpayer” based on its ownership (i.e., the Proportional Ownership Approach) or if some other approach is applicable.

Further, guidance is needed with respect to the determination of the allocation of tax-exempt income from Direct Pay proceeds.

*i. Entity Approach*

If the Entity Approach is adopted for purposes of determining whether a partnership is an “applicable entity” under Section 6417, guidance should clarify that, except for partnerships electing to be treated as applicable entities pursuant to Sections 6417(d)(1)(B), (C) or (D), partnerships are not applicable entities for purposes of Section 6417. Moreover, guidance should clarify that such partnerships may seek Transferability without a reduction in the amount of an ITC pursuant to Section 50(b)(3) and (4)(A)(i), as outlined in Section (II)(b)(iii).

*ii. Proportional Ownership Approach*

If it is determined that a partnership should instead be considered an applicable entity in the same proportion as its ownership is held by applicable entities, additional guidance will be needed to address the following:

- How, and the applicable point in time, to calculate a partnership’s ownership for such purpose, taking into account the potential for changes in ownership over time.
  - A partner’s share of partnership income or gain may vary during the period such partner is a partner in the partnership, and guidance is needed to determine how such ownership is determined at any relevant time of determination. Rules similar to Section 168(h)(6)(C) or Section 45(e)(3)<sup>4</sup> could be applied to determine an applicable entity’s proportionate share of the partnership.<sup>5</sup>
  - It is possible a Mixed Partnership will not be able to readily determine the portion of its ownership that is an applicable entity or an eligible taxpayer without additional information from its partners. This will be exacerbated in the case of tiered partnerships, where the lower-tier partnership may have limited visibility into the ownership of upper-tier partnerships.<sup>6</sup> As a result, if a Proportional Ownership Approach is adopted, guidance should provide rules that require partners in partnerships that are directly or indirectly investing in ITC generating assets to provide information to the relevant partnership in which it invests as to the portion of its

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<sup>4</sup> Rules based on Section 45(e)(3) would need to be expanded to take into account varying ownership throughout a taxable year.

<sup>5</sup> Because ownership may change over time, guidance should clarify the degree to which a change in ownership (either by transfer or variance in allocations of income or gain to a partner) during the recapture period for ITCs will invalidate a portion of the credit that is eligible for Direct Pay or Transferability.

<sup>6</sup> Investors in renewable projects often utilize tiers of partnerships both to accomplish their agreed economic sharing arrangement and to also accommodate the various characteristics and sensitivities of investor groups. Further, the project partnership might not have complete visibility into the owners of the upper-tier partnerships and their tax classification. Under the IRA, the lowest tier partnership appears to be required to make any election under Section 6417 and/or Section 6418, but the existence of tiers of intervening partnerships can create significant uncertainty in applying these rules. Accordingly, guidance on Mixed Partnerships should also address how to apply the rules to tiers of partnerships.

ownership that is owned by applicable entities and the portion owned by eligible taxpayers, including, in the case of a partner that is itself a partnership, any similar information it receives from its partners.

- Importantly, we request clarification that Section 6417(e) (*Denial of Double Benefit*) only reduces to zero the portion of an applicable credit for which a Direct Pay election is made with respect to the portion of the partnership that is treated as an applicable entity.

*iii. Allocations of Tax-Exempt Income*

Guidance is needed to determine a partner’s distributive share of tax-exempt income as a result of the proceeds generated by a Direct Pay election. Pursuant to Section 6417(c)(1)(D), a partner’s distributive share is based on such partner’s distributive share of “the otherwise applicable credit for each taxable year.” However, it is unclear what “otherwise applicable credit” means for these purposes, because, without the application of Section 6417(d)(2), Sections 50(b)(3) and (4)(A)(i) would reduce any applicable ITC.

**b. Transferability – Section 6418<sup>7</sup>**

Similarly, guidance is needed to address the application of Section 6418 to Mixed Partnerships. More specifically, guidance is needed to determine whether the partnership will be viewed as an entity or as an aggregate of its partners for this purpose and to provide that, notwithstanding such view, a Mixed Partnership will always be eligible to elect Transferability.

Further, because Mixed Partnerships include tax-exempt entities that, if they had invested alone, would be entitled to Direct Pay, guidance should provide that, as in Section 6417 with respect to applicable credits, Sections 50(b)(3) and (4)(A)(i) do not apply in determining any eligible credit pursuant to Section 6418.

*i. Entity Approach*

If it is determined that the partnership should be viewed as an entity for purposes of determining whether the partnership is an “eligible taxpayer” under Section 6418, guidance should clarify that partnerships are eligible taxpayers for purposes of Section 6418 regardless of the nature of their ownership.<sup>8</sup>

*ii. Proportional Ownership Approach*

If it is determined that a partnership should be treated as an applicable entity in the same proportion as its ownership is held by applicable entities, additional guidance will be needed to address the following:

- In determining the proportion of a credit for which a Mixed Partnership may elect Direct Pay and Transferability, guidance described above in Section (II)(a)(ii) will likewise be needed.
- A Mixed Partnership may prefer to elect Transferability even if eligible, in part, for Direct Pay, for administrative ease or other non-tax considerations. Accordingly, guidance should provide that even if the Proportional Ownership Approach is adopted, a Mixed Partnership may nevertheless choose to apply the Entity Approach and elect to transfer all eligible credits pursuant to Section 6418 (assuming the other requirements are satisfied) rather than electing

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<sup>7</sup> Guidance should clarify that cash received by a partnership as proceeds from a Transferability election may be distributed to the partners of the partnership pursuant to the partnership agreement regardless of the allocation of the tax-exempt income from such proceeds.

<sup>8</sup> We note a possible exception for partnerships that are owned, directly or indirectly, entirely by applicable entities.

for partial Direct Pay and partial Transferability. Section 6417 contemplates that applicable entities may receive a direct payment from the government for applicable credits; however, Section 6418 defines “eligible taxpayer” as any taxpayer that is not an “applicable entity.” This means that applicable entities are not eligible to elect Transferability. However, excluding applicable entities from Transferability is a result inconsistent with the policy of the IRA of encouraging investment in renewable energy projects and leads to odd results that were perhaps unintended. For instance, under the current construct, an applicable entity could only seek the monetization method that will potentially result in greater proceeds (in the form of a direct payment) than proceeds received from another taxpayer as a result of Transferability.

*iii. Clarifying Section 50(b)(3) and Section 50(b)(4)(A)(i) Will Not Apply*

Because Mixed Partnerships include tax-exempt entities that, if they had invested alone, would be entitled to Direct Pay, guidance should clarify that Section 50(b)(3) and Section 50(b)(4)(A)(i) should not apply in determining the amount of an ITC that is an “eligible credit” for purposes of Section 6418. As noted above, the limitations on tax-exempt ownership of renewable credit property are no longer applicable after the enactment of the IRA, which incentivizes tax-exempt investors to monetize tax credits via Direct Pay.

- Under the Entity Approach, without this clarification, a Mixed Partnership may be eligible to transfer an ITC pursuant to Section 6418, but the eligible credit could be reduced to the extent of the tax-exempt partner ownership.<sup>9</sup> However, if those tax-exempt investors had instead invested directly and not through a Mixed Partnership, the ITC would not be affected by such tax-exempt investors’ ownership pursuant to Section 6417. Pursuant to the Secretary’s authority to issue guidance as may be necessary to carry out the purposes of Section 6418, guidance could treat a partnership as an entity for purposes of determining the amount of the ITC without taking into account tax-exempt ownership of such partnership that would otherwise cause a reduction to the ITC under Section 50(b)(3) and (4)(A)(i).<sup>10</sup> For example, a partnership with tax-exempt partners that are described in Section 50(b)(3) and (4)(A)(i) could be treated under guidance as having 0% tax-exempt ownership for purposes of determining the amount of the ITC that is eligible for Transferability.
- Similarly, in a Proportional Ownership Approach, it is unclear how Section 50(b)(3) and (4)(A)(i) would apply to a Mixed Partnership. The portion of the credit that is eligible for Direct Pay would be determined without applying Section 50(b)(3) and (4)(A)(i), but the portion of the credit not eligible for Direct Pay could be determined taking into account those sections, resulting in a reduction in the amount of eligible credit available for Transferability or monetization by the partners. Pursuant to the Secretary’s authority to issue guidance as may be necessary to carry out the purposes of Section 6418, guidance could treat (i) the portion of a Mixed Partnership allocable to applicable entities as owned by tax-exempt entities but, consistent with Section 6417(d)(2)(A), for which Section 50(b)(3) and (4)(A)(i) is inapplicable and (ii) the partnership as not owned by

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<sup>9</sup> This is so because Section 50(b) applies the rules under Section 168(h)(5) and (6) in applying Sections 50(b)(3) and (4)(A)(i) in calculating the amount of an ITC.

<sup>10</sup> Section 6418(h).

any tax-exempt entities for purposes of determining the amount of the eligible credit for purposes of seeking Transferability or monetization by the partners.<sup>11</sup>

By calculating the eligible credit without the application of Section 50(b)(3) and (4)(A)(i), investors, in particular tax-exempt investors (and partnerships with tax-exempt investors as partners) such as the State Pension Fund described above, will be able to more efficiently structure their investments in renewable energy projects—a result consistent with the stated policy driving the IRA. Because various investors, including tax-exempt investors, may not be experienced in operating and developing renewable energy projects, such investors may generally prefer to invest in these projects through partnerships that are Mixed Partnerships. Having monetization methods that reduce an ITC if the tax-exempt investor invests through a Mixed Partnership that elects Transferability versus investing directly and electing Direct Pay may operate to provide a disincentive for tax-exempt investors to invest in the renewable energy market and for renewable energy developers and operators to seek investment from tax-exempt investors.

Sincerely,



Melissa Standley  
Head of Tax  
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<sup>11</sup> Section 6418(h).