TAXPAYERS for COMMON SENSE

August 14, 2023

Re: Notice and Proposed Rulemaking on Section 6418 Transfer of Certain Credits

Docket No.:
RIN 1545-BQ64

To Whom it May Concern:

Taxpayers for Common Sense (TCS) respectfully submits the following comments to the Department of the Treasury and the Internal Revenue Service (IRS) on Section 6418 Transfer of Certain Credits notice of proposed rulemaking.

TCS is an independent, nonpartisan budget watchdog that has been working on behalf of the nation's taxpayers since 1995. TCS works to ensure that taxpayer dollars are spent responsibly, and that government operates within its means. This includes ensuring that federal energy policy does not create short or long-term liabilities for taxpayers.

TCS advocates for a balanced and responsible approach to tax policy that promotes both fiscal responsibility and fairness. We believe that tax expenditures should be scrutinized to ensure they effectively promote economic growth, innovation, and societal well-being. While targeted tax expenditures can play a role in encouraging specific behaviors and industries, it is essential that they are transparent, well-designed, and regularly evaluated for their cost-effectiveness. We emphasize the importance of a streamlined tax code that minimizes complexity and loopholes, ensuring that all citizens and corporations contribute their fair share to support vital public services and infrastructure. By prioritizing prudent tax policies, we strive to create a level playing field and foster a strong, sustainable economy that benefits all Americans.

The Inflation Reduction Act (IRA) included a suite of expanded and new tax credits aimed at reducing greenhouse gas emissions and mitigating the impacts of climate change. However, in the absence of strong compliance and anti-fraud safeguards, these tax credits will not achieve their intended goals.

The carbon oxide sequestration credit, or 45Q tax credit, provides a cautionary tale due to its record of improper claims. The Treasury Inspector General for Tax Administration reported that between Tax Years 2010 and 2019, $1.026 billion worth of 45Q credits were claimed, and $1.024 billion, or 99.86% of the total, were claimed by only 10 taxpayers. The Internal Revenue Service (IRS) audited the 10 companies that claimed over $100 million each in credits and found that $894 million worth of the credits claimed by these companies did not comply with the Environmental Protection Agency (EPA) monitoring, reporting, and verification requirements for sequestered carbon. The companies had insufficiently documented whether the carbon for which they were claiming credits remained underground. The IRS has reported on their examination of 68% of these cases and has subsequently disallowed 59% of the noncompliant credits, worth approximately $531 million. No further update has been released since April 2020.

Section 6418 of the Code, enacted by Section 13801 of the IRA, allows the transfer of eligible credits from eligible taxpayers to an unrelated taxpayer. TCS supports IRS's proposed rule that generally places recapture risk for tax credits on the transferee to reduce the risk of potential abuse associated with the transferability feature. In the case of an excessive credit transfer or when there is recapture of the tax credit after the transfer and use of the credit by the transferee, the risk of loss is on the transferee. The transferee of the tax credit is the party that must repay the disallowed tax credit as a tax to the government while the transferor of an excessive credit transfer is not subject to liability to the government. The proposed rule also includes a 20 percent penalty for transferees for excessive credit transfers, with an exception for reasonable cause. Prospective transferees may and likely will seek contractual indemnification from the transferor and may include tax credit insurance, which essentially holds the transferor indirectly liable as well. This risk shifting will make the negotiation and documentation of tax credit transfers more involved than if the transferor remained liable to the government. Furthermore, as part of that risk shifting, prospective transferees of tax credits have an incentive to adopt certain due diligence protocols in the hope of demonstrating reasonable cause relief if an excessive credit transfer is determined to apply later. The proposal to make transferee taxpayers bear the risk will better safeguard the transferability feature of credits from potential fraud or improper claims.

TCS supports proposed section 1.6418-2(f)(3)(ii) which clarifies that credits transferred to a taxpayer under section 6418 are considered passive activity credits under section 469 if the transferee taxpayer has not acquired the credit in connection with the taxpayer's trade or business, thereby preventing the transferee taxpayers' abilities to utilize purchased credits in tax years they have tax liabilities stemming from non-passive income. Since the IRA introduced the transferability of certain federal energy tax credits, qualifying credits are now available for sale for cash, rather than having to go through a structured finance transaction using a partnership or lease. This is the first time that federal energy tax credits can be sold and purchased on the secondary market, and a more restrictive rule will better prevent potential fraud and abuse of the transferability feature of the credits.

Embedding targeted subsidies in the tax code - rather than in spending programs - limits the ability of both the public and policymakers to understand, review, and adjust policy choices. Transferability deviates from the program's stated goals by allowing companies that veer from the original intention of the tax credit program to benefit from it. TCS urges the IRS to take all possible precautionary measures to protect taxpayer interests and prevent abuse of this program. Actions to limit abuse of this program will protect taxpayers from unnecessary, additional costs.

We thank you for considering our comments on the proposed rule on section 6418 Transferability of Certain Credits. Please let us know if you have any questions.

Sincerely,

Steve Ellis
President