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Tax Credit Transfer Regs Show IRS Caution In Rulemaking

By **Kat Lucero**

Law360 (May 1, 2024, 1:42 PM EDT) -- The IRS and Treasury's final rules on the sale and transfer of green energy credits maintained a strict reading of the statute while making few changes, a sign of caution by regulators amid judicial scrutiny of the government's rulemaking authority.

The U.S. Department of the Treasury and Internal Revenue Service released the more than 160-page final regulations last week without major changes from the draft that was issued in June. That's despite the receipt of dozens of written comments that called for a much easier compliance process to facilitate a fast-growing market for green energy credits.

In the long preamble, Treasury repeatedly explained that many recommended changes were beyond the scope of the regulations, which are governed by Internal Revenue Code Section 6418.

For example, the department avoided adopting requests to increase the documentation the seller of credits has to provide on its business and the project, saying it wanted to prevent over-regulating arm's-length arrangements. It also declined to address a setup known as "chaining" that involves an entity buying credits from a clean energy developer for a discount and then electing a direct cash payment from the government. Despite requests to clarify whether chaining would be allowed in certain circumstances, Treasury said that was outside the scope of the rules.

While it's standard practice for Treasury and the IRS to discuss stakeholder comments in their rules, recent tax regulations have shown a trend toward more detailed explanations of regulators' decisions in response to recent suits challenging federal agencies' rulemaking authority, practitioners told Law360.

Against this backdrop loom highly anticipated decisions from the U.S. Supreme Court that may roll back the highest deference that federal courts are allowed to give to federal agencies in legal challenges over ambiguous statutes, known as the Chevron doctrine. Some justices have been eager to limit the wide regulatory latitude that courts have granted federal agencies under the doctrine established by the high court in a 1984 opinion in Chevron USA Inc. v. Natural Resources Defense Council.

Treasury and the IRS' detailed discussion of stakeholder comments in the transferability rules reflects the recent challenges lodged against regulations "not just in the tax area, but generally in the Chevron deference arguments before the Supreme Court," said Keith Martin, who leads the U.S. projects practice at Norton Rose Fulbright and specializes in energy tax policy.

The high court is scrutinizing Chevron in a pair of cases known as Loper Bright Enterprises v.

Raimondo and Relentless v. U.S. Department of Commerce. The justices agreed to review the cases last year, both of which asked the court to toss out the doctrine that has long underpinned federal rulemaking, arguing that lower courts were wrong to rely on it to uphold a commercial fishing rule issued by the National Marine Fisheries Service.

While the Loper Bright and Relentless cases do not address tax code regulations, their outcome will likely trickle down to the rulemaking authority of Treasury and the IRS, which has also been under attack in recent suits.

In the U.S. Tax Court and the federal district courts, businesses and individuals have sued the IRS for promulgating certain regulations that they claimed did not follow the Administrative Procedure Act, and those challenges have achieved some success.

That happened in March when a Tax Court majority sided with Valley Park Ranch in its case against a 1986 conservation easement perpetuity provision codified in U.S. Treasury Regulation Section 1.170A-14(g)(6)(ii), which was part of a broader set of rules governing the charitable tax deduction for easement donations. The court revoked the provision for being procedurally invalid under the APA because the IRS failed to address a significant comment during the rulemaking process.

A few years ago, in separate cases, the Tax Court and other federal courts also nullified a 2016 notice that called for additional disclosures of syndicated easements for being potential tax shelters. The court held that the IRS finalized and enforced the notice without complying with the APA's public feedback requirements.

The transferability rules show the government is trying to avoid a repeat of such decisions, practitioners said.

Treasury and the IRS are being "extra careful" in crafting rules so that if "at least some of the Chevron deference goes away, that perhaps what they're writing will stand" and "will not have to be revisited or revoked," said Mary Burke Baker, government affairs counselor at K&L Gates LLP.

The government's wariness was also reflected in final rules for the so-called direct pay tax credit monetization method under IRC Section 6417, also created by the Inflation Reduction Act, Baker said. Treasury finalized the direct pay rules in early March.

Direct pay allows government agencies, tribal governments, nonprofits and other eligible tax-exempt entities for the first time to claim credits on their clean energy development projects and get a direct cash payment for those incentives instead of pursuing the traditional tax equity investments to monetize some of the credit amount.

Congress created two monetization credit regimes under sections 6417 and 6418 to allow entities that had little or zero tax liability to efficiently capitalize clean energy credits without solely relying on the traditional but complicated tax equity arrangements that can absorb the credits.

Treasury and the IRS could not write the rules for those two methods "in a complete vacuum from each other because, to some extent, they're kind of similar policies," Baker said.

Treasury and the IRS also avoided broadening the transferability rules for tax administration reasons, as well as preventing abuses of tax incentives, according to practitioners. The government has recently found fraud and abusive tax shelter schemes involving annuity trusts, easement deductions, the research and development tax credit, and the employment retention tax credit that Congress quickly passed during the COVID-19 pandemic. Some taxpayers that claim they did not have nefarious intentions have sued the IRS for considering their transactions illegal or deficient in tax payments.

"I think that's kind of in the back of their heads," said Carina Federico, a partner at Crowell & Moring LLP.

In finalizing the rules, Treasury and the IRS said, "'Let's try to make this as easy to audit as possible ... so that we're able to control'" transactions more than we have been able to control some of the other programs, she said.

--Editing by Aaron Pelc and Neil Cohen.
