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Author
Aprill, Ellen P

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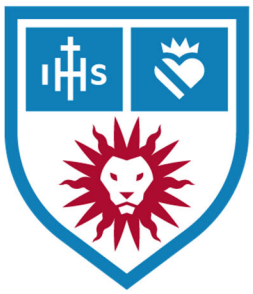

Loyola Law School
Loyola Marymount University
Los Angeles

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Comment Letter re Treasury and IRS Guidance on IRC § 6417, Elective payment of applicable credits

Professor Ellen Aprill

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Loyola Law School
Loyola Marymount University
Los Angeles

919 Albany Street
Los Angeles, California
90015

T 213.736.1000 F 213.736.1001
www.lls.edu

Ellen P. Aprill
John E. Anderson Professor of Tax Law Emerita

Cell: 213-247-2488
Ellen.Aprill@lls.edu

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Office of the Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service
Washington, D.C. 20044

Via Federal eRulemaking Portal at: www.regulations.gov (IRS-2022-0050)

Re: Question 5(a) of Notice 2022-50

This submission responds to the request in question 5(a) of Notice 2022-50 regarding comments on guidance to be issued under section 6417(d)(1)(A). In particular, it recommends treating entities all of whose income is excluded under section 115(1) ("section 115(1) exclusion entities") as exempt organizations under section 6417(d)(1)(A)(i). I use "section 115(1) entities" here to refer to those entities without income pursuant to section 115(1), which states that gross income does not include "income derived from . . . the exercise of any essential governmental function and accruing to a State or any political subdivision thereof, or the District of Columbia."

I offer these thoughts as an academic who has been writing for three decades on federal tax treatment of state governments, their political subdivisions, and their affiliated entities.[1] I do not practice law and thus have no clients for whom this issue is of interest.

As Secretary Yellen has stated, the Inflation Reduction Act is "the most significant investment in clean energy in our nation's history."[2] Section 6417 advances that effort by allowing various tax-exempt and government entities to monetize a number of energy credits. None of the statutory subsections of section 6417(d)(1)(A) defining an applicable entity explicitly addresses section 115(1) exclusion entities. *Cf.* section 4960(c)(1)(C). As I argue below, regulatory guidance can and should include section 115(1) exclusion entities as an applicable entity under section 6417(d)(1)(A)(i).

[1] *See* Ellen P. Aprill, *Revisiting Federal Tax Treatment of State, Political Subdivisions, and Their Affiliates*, 23 Florida Tax Review 73 (2019); Ellen P. Aprill, *The Tax Status of Public Universities,* Tax Notes (January 22, 2018); Ellen P. Aprill, *The Integral, the Essential, and the Instrumental: Federal Income Tax Treatment of Governmental Affiliates,* 23 The Journal of Corporation Law 803 (1998), reprinted in 23 Exempt Organizations Tax Review 263 (1999); Ellen P. Aprill, *Excluding the Income of State and Local Governments: The Need for Congressional Action,* 26 Georgia Law Review 421 (1992), reprinted in 6 The Exempt Organization Tax Review 691 (1992). I note that these articles also discuss at length the meaning of "integral part" of a state or political subdivision, an issue under section 7701 on the 2022-2023 Priority Guidance Plan.

[2] U.S. Department of the Treasury, Secretary Statements and Remarks, October 26, 2022, https://home.treasury.gov/news/press-releases/jy1054.

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Section 6417(d)(1)(A)(ii) lists "any State or political subdivision thereof" as one category of applicable entity. Under longstanding IRS guidance, however, section 115(1) exclusion entities are not political subdivisions. As the IRS's government information letter as well as other authorities make clear,[3] section 115(1) exclusion entities and political subdivisions belong to distinct and separate categories; a political subdivision must have substantial sovereign power; a section 115 exclusion entity must have none. That is, a section 115 exclusion entity does not qualify as a political subdivision; a political subdivision does not qualify as section 115 exclusion entity. Thus, I do not recommend interpreting section 6417(d)(1)(A)(ii) to include section 115(1) exclusion entities. To do so would contradict and undermine IRS key interpretations of both categories of entities.

Nonetheless, a section 115(1) exclusion entity is a governmental affiliate, as the IRS information letter, among other guidance, recognizes. The policy underlying these new energy credits calls for extending them to section 115(1) exclusion entities. A number of considerations, detailed below, support interpreting section 6417(d)(1)(A)(i), which lists as one category of applicable entity as "any organization exempt from the tax imposed by Subtitle A," to include section 115(1) exclusion entities.

First, section 6417(d)(1)(A)(i) refers to organizations exempt under "Subtitle A." Other code provisions require exemption under section 501(a). *See* section 4960(c)(1)(A). Thus, regulations need not limit this category of section 6417 applicable entities to exempt organizations under section 501(a). It permits a more capacious definition of "an organization exempt from tax," one that includes all organizations not subject to income tax under Subtitle A.

Second, Treasury and the IRS have treated section 115(1) exclusion entities as exempt entities elsewhere in the Internal Revenue Code, as Benjamin A. Davidson has pointed out.[4] In the context of corporate liquidations, section 337(b)(2) addresses distribution of property to an "organization . . . which is exempt from the tax imposed by this chapter." Treas. section 1.337(d)-4(c)(2) defines tax-exempt entity to include "states, political subdivisions, and entities whose income is excluded under section 115."

Third, IRS guidance in the form of private letter rulings has at times treated section 115(1) as a kind of exemption as well as an exclusion. *See, e.g.,* PLR 200836005 (May 29, 2008) (describing a member of the organization as "an entity exempt from federal income tax under section 115(1)); PLR 9727004 (March 17, 1997) (describing dues-paying members of the organization as "exempt from income tax under Code section 115"); PLR 8748017 (concluding that organization "is not exempt from federal income tax under section 115 of the Code"); PLR 8431016 (April 27, 1984) (stating that organization as "exempt from federal income tax under section 115(a) [sic] of the Internal Revenue Code"); PLR 8311052 (Dec 14, 1982) (concluding that income of organization "is exempt from federal income tax under the provisions of section 115 of the Code"). Of course, private letter rulings are not precedential but these rulings demonstrate how even those administering the provision describe it, in the same document, as both an exclusion and an exemption.

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[3] *See* IRS, Governmental Information Letter, https://www.irs.gov/government-entities/federal-state-local-governments/governmental-information-letter as well as guidance cited in the articles listed in *supra* note 1.

[4] Benjamin A. Davidson, Letter to the Editor, Tax Notes Federal (August 22, 2022), at 176-177.

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Further, I note that expert commentators and section 115 exclusion entities themselves often understand the provision as a kind of exemption. *See* Matthew T. Journy, *A Broader Tax Exemption – Excluding Income Related to Government Functions,* TAXATION OF EXEMPTS (January-February 2016), https://www.gkglaw.com/site/files/00351338.pdf; Craig Ashford and Kevin Reed, *Public Universities and the Tax on Tax-Exempt Employee Compensation,* https://www.aplu.org/members/councils/governmental-affairs/CGA-library/public-universities-and-the-excise-tax-on-tax-exempt-employee-compensation/file; Arkansas Tech University, Miscellaneous Information, https://www.atu.edu/research/miscinfo.php; Texas Tech University, Procurement Services, To Whom It May Concern Exemption Letter, https://www.depts.ttu.edu/pss/files/forms/TTU-Tax-Exempt-Letter.pdf; University of Oklahoma, Vice President for Research and Partnerships, Institutional Information for Researchers, https://ou.edu/research-norman/research-services/institutional-information.

Finally, section 6417(h) grants the Secretary authority "issue such regulations or other guidance as may be necessary to carry out the purposes of this section." That is, the grant of regulatory authority is broad. Contrast, for example, section 4960(d), which gives the Secretary authority only to "prescribe such regulations as may be necessary to prevent avoidance of the tax under this section,"

In sum, the purpose of section 6417, the language of the statute, analogous guidance, IRS private letter rulings, statements by commentators as well as section 115(1) exclusion entities themselves, and the statutory grant of regulatory authority all support a regulatory definition of "exempt" in section 6417(d)(1)(A)(i) similar to the broad, common understanding of "exempt" as found in dictionaries – "free or released from some liability or requirement to which others are subject."[5] I urge Treasury and the IRS to do so and to treat section 115(1) exclusion entities as exempt organizations for purposes section 6417.

Very truly yours,

Ellen Aprill

Ellen P. Aprill
John E. Anderson Professor of Tax Law Emerita

cc:
Lily Batchelder, Assistant Secretary for Tax Policy
Tom West, Deputy Assistant Secretary for Tax Policy
Krishna Vallabhaneni, Office of Tax Policy
Amber MacKenzie, Office of Tax Policy
William Paul, IRS Office of Chief Counsel
Rachel Levy, IRS Office of Chief Counsel

[5] "Exempt," Merriam-Webster Online dictionary, https://www.merriam-webster.com/dictionary/exempt.

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