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Final and proposed regulations: Access to clean energy tax credits for co-owned projects through elective pay ("direct pay")

The U.S Treasury Department and IRS today released [final regulations](#) (T.D. 10012) that modify existing rules to allow certain unincorporated organizations owned in whole or in part by certain "applicable entities" to elect to be excluded from the application of the partnership tax rules. In addition to the final regulations, proposed regulations (REG-116017-24) were released providing additional administrative requirements for such unincorporated organizations electing to be excluded from the application of partnership tax rules. The regulations also update certain outdated language in existing regulations.

Background

Section 6417, added by the "Inflation Reduction Act of 2022" (IRA), allows applicable entities (which include tax-exempt organizations, the District of Columbia, state and local governments, Indian Tribal governments, Alaska Native Corporations, the Tennessee Valley Authority, rural electric cooperatives, and certain agencies and instrumentalities) to elect to treat certain tax credits as payments against their tax liabilities for the year the credit is determined ("elective pay"). Section 6417 applies to tax years starting after December 31, 2022.

Final regulations under section 6417 published in March 2024 clarify that partnerships are not considered applicable entities purposes of the elective pay rules regardless of whether the partnership has partners that are applicable entities. Those final regulations further provide that applicable entities can still qualify for elective pay if they are treated as co-owning applicable credit property through an organization that has elected out of partnership tax rules under section 761(a).

Proposed regulations under section 761(a) also published in March 2024 amended the existing rules under section 761(a) to allow certain unincorporated organizations owned in whole or in part by applicable entities to elect to be excluded from the application of the partnership tax rules.

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Final regulations

The final regulations under section 761(a) clarify that eligible co-ownership arrangements can own and operate property for any clean energy tax credits available for elective pay and invest through noncorporate

entities like LLCs. The regulations allow unincorporated organizations meeting the following requirements to elect out of the application of the partnership tax rules:

- The unincorporated organization is owned, in whole or in part, by one or more applicable entities
- The unincorporated organization's members entered into a joint operating agreement with respect to the applicable credit property in which the members reserve the right separately to take in kind or dispose of their pro rata shares of any property produced, extracted, or used, and any associated renewable energy credits or similar credits
- The unincorporated organization is, pursuant to a joint operating agreement, organized exclusively to own and operate applicable credit property
- One or more of the applicable entities will make an elective payment election under section 6417(a) for the applicable credits determined with respect to its share of the applicable credit property
- The members are able to compute their income without the necessity of computing partnership taxable income
- The unincorporated organization is not a syndicate, group, pool, or joint venture which is classifiable as an association, or any group operating under an agreement which creates an organization classifiable as an association

The final regulations significantly expand the types of organizations that are eligible to elect out of the application of the partnership rules. Under the proposed regulations released in March 2024, only unincorporated organizations created exclusively to jointly produce electricity from its applicable credit property were eligible to make the election under section 761(a). The final regulations revised the definition of an applicable unincorporated organization to include organizations exclusively to own and operate all applicable credit property as defined in Treas. Reg. §1.6714-1(e).

The final regulations also finalized the rule in the proposed regulations with respect to the joint marketing requirement allowing a participant's delegee to enter into contracts for longer than a year in duration that bind a participant to sell its share of the property produced from the applicable credit property as long as the participant is not bound to the agency relationship with the delegee for longer than one year.

Proposed regulations

Concurrently with the release of today's final regulations, Treasury and the IRS released proposed regulations (REG-116017-24) outlining additional administrative requirements for unincorporated organizations electing out of the application of the partnership tax rules.

The proposed regulations clarify that an applicable unincorporated organization making a section 761(a) election must submit all information required by the Form 1065 instructions and that the deemed election rule in Treas. Reg. §1.761-2(b)(2)(ii) does not apply to applicable unincorporated organization that use the "specified modifications" (owning the applicable credit property through a unincorporated organization that is an entity or that has participants that enters into contracts for longer than a year in duration that bind a participant to sell its share of the property produced from the applicable credit property as long as the participant is not bound to the agency relationship with the delegee for longer than one year) (a "specified applicable unincorporated organization").

These proposed regulations also provide that a specified applicable unincorporated organization's section 761(a) election terminates upon a regarded acquisition or disposition of an interest in the applicable unincorporated organization (a "terminating transaction"). If the organization continues to meet the requirements to make a new section 761(a) election following a terminating transaction, it may maintain its section 761(a) election if it timely makes a new election providing required information to the IRS.

Additionally, the proposed regulations clarify that a request to revoke a section 761(a) election must be made by submitting a private letter ruling request.

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