

Treasury and IRS Issue Final and Proposed Regulations Expanding Applicable Entities' Ability to Elect Direct Pay in Connection With Credit Property Owned Indirectly Through an Unincorporated Organization

Update

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On November 19, 2024, the Treasury Department and the Internal Revenue Service issued [final regulations](#) under Internal Revenue Code (Code) Section 761 (the Final Regulations) enabling certain entities to make a direct pay election with respect to tax credits earned in respect of applicable credit property owned indirectly through certain unincorporated organizations, such as limited liability companies. Simultaneously with the issuance of the Final Regulations, [proposed regulations](#) under Code Section 761 (the Proposed Regulations) were issued to address certain related administrative matters.

Background

Under Code Section 6417, certain entities, including any organization exempt from tax under subtitle A of the Code, and any State or political subdivision thereof (Applicable Entities), are eligible to make direct pay elections with respect to certain tax credits. If, however, a partnership, owned in whole or in part by one or more Applicable Entities, earns an applicable tax credit, the partnership generally is not eligible to make a direct pay election for the benefit of any direct or indirect owner that is an Applicable Entity. Partnerships, however, may be eligible to make a direct pay election with respect to tax credits under Code Sections 45Q, 45V or 45X for a limited period of time.

Final Regulations

The Final Regulations permit Applicable Entities that indirectly own applicable credit property through an unincorporated organization, such as a limited liability company, to be treated as the direct owners of such property for purposes of the direct pay election if the unincorporated organization qualifies

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as an “applicable unincorporated organization” and properly makes an election to be excluded from the partnership rules. Electing out of the partnership rules would enable each Applicable Entity that is an owner of such unincorporated organization to elect direct pay with respect to its indirect ownership interest in the applicable credit property.

In general, an “applicable unincorporated organization” is an unincorporated organization:

- owned, in whole or in part, by one or more Applicable Entities;
- the members of which enter into a joint operating agreement in which the members reserve the right to take in kind or dispose of their pro rata shares of any property produced, extracted or used, and any associated renewable energy (or similar) credits;
- organized exclusively to own and operate any applicable credit property;
- with respect to which the participants can compute their income without the necessity of computing partnership taxable income; and
- which is not a syndicate, group, pool or joint venture which is classified as an association, or any group operating under an agreement which creates an organization classified as an association for US federal income tax purposes.

The Final Regulations expand the scope of organizations that were eligible to elect out of the partnership rules under the proposed regulations under Code Section 761 issued in March 2024. Those proposed regulations required the organization to be established exclusively to produce electricity from applicable credit property. The Final Regulations broaden the scope to include organizations established to own and operate any applicable credit property.

Consistent with the proposed version of the regulations, the Final Regulations provide that an applicable unincorporated organization may delegate authority to an agent who enters into contracts with a duration in excess of the minimum needs of the industry and one year, provided that the duration of the delegation of authority does not exceed the minimum needs of the industry or, if shorter, one year. An example in the Final Regulations indicates that the participants may extend the delegation of authority to the agent by entering into a new agent delegation agreement with substantively identical terms at the time that the prior agreement terminates.

The Final Regulations apply to taxable years ending on or after March 11, 2024.

Proposed Regulations

In addition to addressing certain other matters, the Proposed Regulations provide that the transfer of an interest in an applicable unincorporated

organization generally terminates any election out of the partnership rules. However, a transfer will not terminate an election out of the partnership rules if the organization is eligible to make, and makes, a new election out of the partnership rules following the transfer. In addition, a transfer between a disregarded entity and its owner is ignored.

The Proposed Regulations apply to taxable years ending on or after November 20, 2024.