

THE JOURNAL OF FEDERAL AGENCY ACTION

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Key Highlights of Internal Revenue Code Section 761 Final Regulations and Impact on Internal Revenue Code Section 6417 Direct Payments

Amish Shah, Bryan Marcelino, Brad M. Seltzer, Nicole M. Elliott, Elizabeth Crouse, David H. Mann, Roger David Aksamit, and Joshua David Odintz*

In this article, the authors examine final regulations under Section 761 of the Internal Revenue Code that were adopted effective January 19, 2025.

The U.S. Department of the Treasury and the Internal Revenue Service (IRS) on November 20, 2024, issued final regulations under Section 761 of the Internal Revenue Code. These regulations provide detailed guidance on how certain unincorporated organizations wishing to avoid being treated as partnerships for U.S. federal income tax purposes, including to be able to claim direct payments of energy tax credits under Section 6417 of the Code, can make an election out of the partnership rules of Subchapter K (the Final 761 Regulations).

Effective January 19, 2025, the Final 761 Regulations generally adopt the proposed regulations (with certain modifications) issued in March 2024 (the First Proposed 761 Regulations).

Concurrently with the publication of the Final 761 Regulations, the Treasury Department and IRS also issued additional proposed regulations to further add to and revise certain administrative requirements for unincorporated organization electing out of the application of the partnership rules under Subchapter K (the Second Proposed 761 Regulations).

Background

Under Section 6417 of the Code, as enacted by the Inflation Reduction Act (IRA), certain taxpayers that fall within the statutory

definition of “applicable entities” are allowed to elect to receive a direct payment (i.e., make an elective payment election) in lieu of a tax credit. Other than under specific and limited circumstances, partnerships and S corporations are generally not considered applicable entities and, therefore, are not eligible to make this elective payment election. That said, the Treasury Department and IRS created a special rule allowing applicable entities that co-own certain property through an “unincorporated organization” that, in turn, is eligible to and has made an election out of the partnership rules under Subchapter K (a Section 761(a) Election) to qualify for elective pay under certain circumstances. To provide further guidance on the Section 761(a) Election, the Treasury Department and IRS released the First Proposed 761 Regulations.

Final 761 Regulations

Below is a summary of the key changes of the Final 761 Regulations.

Eligibility

Under the First Proposed 761 Regulations, only certain unincorporated organizations, owned in whole or in part by applicable entities, that were created exclusively to jointly produce electricity from certain property (i.e., the “applicable unincorporated organizations”) were eligible to make a Section 761(a) Election. The Final 761 Regulations helpfully expanded the scope of unincorporated organizations that were eligible to make a Section 761(a) Election to include unincorporated organizations that own and operate property for any clean energy tax credit under the IRA that are available for an elective payment election under Section 6417, as long as the following requirements are met:

- *Co-Ownership Requirement.* The unincorporated organization is owned, in whole or in part, by one or more applicable entities.
- *Severance Requirement.* The members of such unincorporated organization enter into a joint operating agreement 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, along with any associated renewable energy credits or similar credits.

- *Purpose of Organization.* The unincorporated organization is, pursuant to the joint operating agreement, organized exclusively to own and operate “applicable credit property” (as defined in Treasury Regulation § 1.6417-1(e)).
- *Elective Payment Election.* One or more of the applicable entities will make an elective payment election under Section 6417(a) for the “applicable credits,” as defined in Section 6417(b), determined with respect to its share of the applicable credit property.
- *Separate Income Computation.* The members of such unincorporated organization are able to compute their income without the necessity of computing partnership taxable income.
- *Non-Association.* The unincorporated organization is not a syndicate, group, pool, or joint venture that is classifiable as an association or any group operating under an agreement that creates an organization classifiable as an association.

Joint Marketing Modification and Agent Delegation Rule

An existing rule generally prohibited unincorporated organizations from making a Section 761(a) Election if they jointly marketed services or property, though they could delegate such authority to an agent for no more than one year. The First Proposed and the Final 761 Regulations modified this agent delegation rule concerning joint marketing. Under this revised rule, an agent may be delegated authority on terms identical to those in a past year, provided that the delegation of joint marketing authority to act is not for a period of time that exceeds the minimum needs of the industry and each member delegating authority to that agent consents to those terms in writing at least once per year.

Notably, this modification to the existing rule, as finalized, aligns with the prior guidance and with industry practices and provides flexibility in managing the sale of produced property.

Partnership Flip Structures

The Treasury Department and IRS clarify that partnership flip structures (i.e., where the allocation of income, gains, losses, deductions, or credits changing at some point after a partnership is formed) are not eligible to make a Section 761(a) Election. In the preamble to the Final 761 Regulations, the Treasury Department

and IRS explained that such structures violate existing statutory requirements for electing out of Subchapter K.

Notably, partnership flip structures are also arguably incompatible with the right of severance requirement, under which members must reserve the right separately to take in kind or dispose of their shares of any property produced, extracted or used because members do not have a determinate “share” of the applicable credit property. Thus, this clarification ensures adherence to the consistent allocation of tax attributes amount members.

Second Proposed 761 Regulations

The Second Proposed 761 Regulations address key administrative requirements, including the process for unincorporated organizations to make valid Section 761(a) Elections and rules governing the timing and revocation of such elections. Additionally, the preamble to these regulations highlights Treasury Department and IRS effort to modernize certain outdated provisions of Subchapter K and invites public comments on the proposed rules before they are finalized.

- *Election Process.* The Section 761(a) Election must be made by including a statement with a properly executed Form 1065 (U.S. Return of Partnership Income). This statement must provide the following information:
 - Certain identifying information of the unincorporated organization and its members, a declaration of qualification for the election or a statement;
 - A statement that the unincorporated organization qualifies under Treasury Regulation § 1.761-2(a)(1) and either Treasury Regulation §§ 1.761-2(a)(2) or (3) (taking into account revised Treasury Regulation § 1.761-2(a)(4), as applicable);
 - A statement that all of the members of the unincorporated organization elect to be excluded from all of Subchapter K; and
 - A statement indicating where a copy of the agreement under which the organization operates is available (or if the agreement is oral, from whom the provisions of the agreement may be obtained).

- *Revocation of Election.* The Second Proposed 761 Regulations would also update the procedure for obtaining permission to revoke a Section 761(a) Election by clarifying that such an application must be made by submitting a letter ruling request that complies with the requirements of Revenue Procedure 2024-1 or successor guidance. Taxpayers may continue to submit applications for permission to revoke an election by requesting a private letter ruling and can rely on the process in Revenue Procedure 2024-1 or successor guidance prior to the date regulations finalizing the Second Proposed 761 Regulations are published in the Federal Register.

Finally, the Second Proposed 761 Regulations also provide that an unincorporated organization's Section 761(a) Election generally terminates as a result of a "terminating transaction," subject to limited exceptions. A "terminating transaction" is the acquisition or disposition of an interest in a unincorporated organization (including transfers of such interest among members of the unincorporated organization), other than as the result of a transfer between a disregarded entity and its owner (since such transfer does not change the identity of the applicable entity for purposes of Section 6417).

Notably, many applicable entities—which include tax-exempt entities, governmental entities, the Tennessee Valley Authority, Indian Tribal governments, Alaska Native Corporations, and electric cooperatives—operate clean energy projects through partnerships for various business and financing reasons. The Final 761 Regulations provide welcome relief to those applicable entities, allowing a path to obtaining a direct payment of energy tax credits to facilitate the development of additional energy infrastructure.

Note

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