NPRM: Election to Exclude Certain Unincorporated Organizations Owned by Applicable Entities from Application of the Rules on Partners and Partnerships

Consultation Summary and Federal Response

Introduction

On April 5, 2024, the U.S. Department of the Treasury (Treasury) held a consultation on the Notice of Proposed Rulemaking (NPRM) that was published on March 11, 2024. The NPRM is entitled "Election to Exclude Certain Unincorporated Organizations Owned by Applicable Entities from Application of the Rules on Partners and Partnerships" (REG-101552-24).

The NPRM contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 761(a) of the Internal Revenue Code (Code) to carry out the purposes of elective payment of applicable credits (Elective Pay) under section 6417 of the Code. Section 6417 was enacted in the Inflation Reduction Act of 2022 (IRA).

Details about the topics of conversation for the consultation can be found in the Dear Tribal Leader Letter, published on March 5, 2024. The consultation was held virtually to maximize Tribal participation across Indian Country. Around 30 attendees joined the consultation and three letters were received. The comment period was initially set to end on May 10, 2024, but it was extended through May 24, 2024.

Pursuant to Treasury's Tribal consultation policy, below is a summary of the feedback received in Tribal consultation.

Broad Feedback

Commenters generally praised the NPRM for addressing joint ownership entities, which are a common structure for Tribal energy development. However, some commenters stated that the options enabled by the NRPM generally provide less economic flexibility as compared to traditional partnership structures with which entities are familiar, and one commenter noted additional transaction costs.

Outreach and Education

A commenter commended Treasury for the Tribal outreach relating to elective pay and for using a Tribal example in the proposed section 761 Regulations. Considering the complexity of elective pay, the commenter urged Treasury to increase the amount of elective pay-related outreach and education and to include Tribal examples in future regulatory and non-regulatory elective pay guidance (such as FAQs). The commenter requested that Treasury highlight how Tribes have successfully used elective pay to showcase how Tribes can access elective pay.

Federal Response: We understand that Tribal governments have unique resource constraints different from other governments. To support understanding of the benefits of this proposed rule, we included a Tribal example. We have also conducted Tribal specific IRA webinars that explain how Tribes and Native entities can access elective pay, including through the use of joint ownership arrangements. As requested, we intend to continue this educational training.

Tribal Statistical Areas

For the Energy Communities guidance, some commenters asked that Treasury consider the use of Tribal statistical areas, like Tribal census tracts or reservation boundaries, in place of census tracts. Tribal areas share census tracts with non-Tribal populations, which can skew or hide Tribal statistics by dilution with non-Tribal data that often represent populations with higher incomes. One commenter proposed using a defined radius around an applicable energy facility (for example, a closed coal plant) including the entirety of any reservation and any portion that falls within that radius.

> **Federal Response:** Treasury is still considering these requests. The content of the Energy Communities guidance, however, is beyond the scope of this guidance.

Tribally Chartered Corporations

A commenter asked that Treasury clarify the tax status of Tribally chartered corporations, asking Treasury to issue guidance affirming that Tribally chartered corporations (whether wholly, jointly, or majority owned) share the same tax status as the Tribal government.

> **Federal Response:** The treatment of entities wholly owned by Tribal governments is the subject of another rulemaking. On October 7, 2024, Treasury issued proposed regulations that would provide that entities that are wholly owned by Tribes and organized or incorporated exclusively under the laws of the Tribes that own them generally are not recognized as separate entities for Federal tax purposes. The proposed regulations would also provide that, for purposes of making certain elective payment elections (including determining eligibility for and the consequences of such elections) for certain energy credits under the Inflation Reduction Act of 2022, these entities and certain Tribal corporations chartered by the Department of the Interior (DOI) are treated as an instrumentality of one or more Indian Tribal governments or subdivisions thereof. Please see the proposed rule and our October 7, 2024, Dear Tribal Leader Letter to learn more.

Tribal Responses to Consultation Questions

1. What questions and/or comments do Tribal governments have with regard to the four eligibility requirements for the proposed exceptions to co-ownership and joint marketing requirements in the case of an unincorporated organization seeking to claim Elective Pay for tax credits generated by applicable credit property held by the organization?

Taking Ownership Share In Kind

A commenter asked whether it is necessary for the respective owners to be able to take their ownership share "in kind" and explained that it is unreasonable for members in an LLC to structure the sale or transfer of member interests in such a way.

> **Federal Response:** It is long-standing regulatory requirement[1] for unincorporated organizations electing out of partnership tax status under subchapter K that each respective owner to be permitted contractually to take its ownership share of any property used or produced in kind. The proposed regulations reiterated this requirement. Pursuant to §1.761-2(a)(4)(ii)(B), each member of an applicable unincorporated organization is

1 26 CFR §1.761-2(a)(3)(ii)

required to reserve the right separately to take in kind or dispose of an amount of property produced, extracted, or used by the members (and any associated renewable energy credits or similar credits) that is proportionate to that member's ownership of the applicable unincorporated organization. The determination of each member's ownership interest of an unincorporated organization (and, accordingly, each member's proportionate share of property produced, extracted, or used) must be made by the members and based on their ownership interests in the same manner as if they were co-owners in the underlying properties. The final regulations (Final Rules) do not prescribe the method for making this this determination.

One Year Delegation Requirements

A commenter asked that Treasury explicitly clarify that Person Q in the scenario provided can also be a third-party manager of the LLC formed to own the energy project and that if the third party manages the LLC, the one-year delegation limitation should be removed because they viewed it as unnecessary.

Federal Response: The preamble to the Final Rules explains that the members of an unincorporated organization are permitted to have a representative handle management and ministerial duties typical of a managing member of a limited liability company or general partner of a limited partnership without violating these requirements. This person can also serve as an agent that sells any property produced or used on behalf of the owners.

The preamble to the Final Rules also provides that provided the agent delegation rule and all other requirements under section 761(a) are satisfied, the joint marketing modification allows members of an applicable unincorporated organization to contract with an agent allowing the agent to enter into contracts of any duration. Multiple members of the same applicable unincorporated organization may be party to the same contract. Members can also choose to sell their shares without a multi-year contract.

Regarding the agent delegation rule, the purpose of this rule is to fulfill the statutory requirement in section 761(a)(2) that no organization making a section 761(a) election is formed "for the purpose of selling services or property produced or extracted." This is a prohibition on joint marketing; accordingly, any member of an unincorporated organization may have an agent for any duration of time, provided that the agent does not represent more than one member of the applicable unincorporated organization. The agent delegation rule applies to any person or group of people acting on behalf of more than one member of an unincorporated organization, regardless of their status as an applicable entity.

The longstanding one-year exception to the joint marketing requirement reflects a balancing of the statutory language with commercial necessities, and the proposed regulations reflected a similar balancing. Section 761(a)(2) does not permit an electing organization to conduct sales through an agent with indefinite authority on behalf of multiple members. Such a structure is necessarily "availed of…for the purpose of selling services or property produced or extracted…" and is not eligible to elect out of subchapter K. The Treasury Department and IRS therefore do not adopt the suggestions to eliminate the agent delegation rule or allow agent delegations to automatically renew. However, in any given year, an agent may be delegated authority on terms identical to those in a past year, provided that each member delegating authority to that agent consents to those terms in writing at least once per year. Example 3 has been added in revised §1.761-2(a)(4)(iv)(C) to illustrate this rule.

Deemed Election Rule

A commenter stated that the proposed section 761 Regulations provided that the Treasury Department and the IRS are considering a rule that would prevent the deemed election rules in Treas. Reg. §1.761-2(b)(2)(ii) from applying to any unincorporated organization that relies on the proposed regulation's partnership opt-out election. The commenter stated that the deemed election rule is helpful because it prevents a situation in which an elective pay partnership opt-out election is inadvertently disallowed in a non-abusive situation (e.g.., where a valid Section 761 election was intended and is warranted, but formal election procedures were not followed).

The commenter explained that allowing the existing deemed election rule to apply in the context of the partnership opt-out election is consistent with the proposed section 761 Regulations stated goal to "further the intent of Congress to encourage applicable entities to build, operate, and own renewable energy projects" and thus expand access to elective pay, since it would prevent applicable entities from inadvertently losing the benefit of elective pay in such non-abusive situations. Additionally, although the deemed election is an existing rule, retaining it would be consistent with the general approach in the proposed section 761 Regulations of applying "relaxed" section 761 election requirements in the limited context of applicable entities seeking elective pay.

Federal Response: The Final Rules do not incorporate a rule that prevents the deemed election rule in §1.761-2(b)(2)(ii) from applying to any unincorporated organization relying on a modification in proposed §1.761-2(a)(4)(iii).

However, the Treasury Department and the IRS have determined that more administrative guidance is needed under section 761(a) to fulfill the purposes of section 6417. As a result, concurrently with the publication of the Final Rules, the Treasury Department and the IRS are publishing proposed regulations under section 761(a) (REG-116017-24) that would provide rules affecting the validity of elections under section 761(a) by applicable unincorporated organizations whose elections would not have been valid without the application of revised §1.761-2(a)(4)(iii) (a "specified applicable unincorporated organization"). The proposed regulations would provide that the deemed election rule in §1.761-2(b)(2)(ii) does not apply to a specified applicable unincorporated organization. This change is necessary to ensure that an unincorporated organization cannot benefit from the modifications in revised §1.761-2(a)(4)(iii) without providing written information to the IRS about its members. The change also ensures that a specified applicable unincorporated organization that terminates as the result of a terminating transaction cannot have its election restored without making a new election in writing. However, if such an organization can make a valid section 761(a) election without the application of either of the specified modifications in revised §1.761-2(a)(4)(iii), the organization may be deemed to make such an election under the deemed election rule.

2. What questions and/or comments do Tribal governments have with regard to the proposed changes to the co-ownership requirement?

A commenter commended the change overall and welcomed the ability to opt-out of Subchapter K, stating that the changes are necessary to support Tribal energy project ownership as an economic development tool.

Federal Response: We appreciate the feedback and hope the increased examples in the Final Rules provide applicable entities with an improved understanding of how this rule operates.

3. What questions and/or comments do Tribal governments have with regard to the proposed changes to the joint marketing requirement?

A commenter stated that it is unclear why the one-year limitation on delegation of authority to sell the electricity is necessary, especially since there are ways to circumvent the limitation, like through a long-term purchase agreement. Another commenter asked Treasury to allow an organization to delegate authority to an agent for more than one year, which would reduce the complexity of seeking the tax credits and respect the sovereignty and self-determination of Tribes by allowing them to seek the arrangements that best fit their circumstances.

Federal Response: Please see our response to the one year delegation comment on page 3 of this summary which explains the reason for the joint marketing modification and the agent delegation requirement.

4. Are similar exceptions necessary for joint ownership arrangements of that own applicable credit properties that do not produce electricity? If so, please explain why.

Commenters generally asked that all 12 elective pay credits be eligible for election out of subchapter K. Several commenters argued that the proposed exemption should also apply to co-ownership of all projects eligible for the elective payment of tax credits, including projects that produce hydrogen or other alternative fuels, and electric vehicle charging stations and carbon capture.

Federal Response: The Treasury Department and the IRS agree that organizations formed to own applicable credit property with respect to which any applicable credits (including credits other than those for electricity generation) are determined should be permitted to apply the modifications to the existing section 761(a) rules contained in the proposed regulations. Accordingly, pursuant to the authority in sections 761(a) and 6417(h), the Final Rules revise the definition of an applicable unincorporated organization to include organizations organized exclusively to own and operate applicable credit property with respect to which one or more applicable credits listed in section 6417(b) is determined.

5. Does the NPRM provide a viable alternative to mixed partnerships?

A commenter expressed appreciation for the NPRM's co-ownership flexibility by allowing Tribes multiple options to form co-ownership arrangements with other applicable entities (such as public power companies, cooperatives, non-profits, or other governments), which can expand the deployment of clean energy projects on and near Tribal lands.

Federal Response: We appreciate the feedback and again hope that the increased examples in the Final Rules provide applicable entities with an improved understanding of how this rule operates.

6. What other questions or comments, if any, do Tribal governments have regarding any of the remaining regulations in the NPRM?

Additional Tribal Structures

A commenter asked that Treasury and the IRS clarify how both envision the use of this structure for a certified Tribal energy development organization, multi-Tribal owned section 17, or other Tribally chartered companies; whether these enterprise structures, if owned in whole or in part by a Tribe or Tribes, will be able to avail themselves of the opt-out process under Subchapter K (assuming they meet the four proposed requirements).

Federal Response: As noted above, the treatment of entities that are wholly owned by Tribal governments are the subject of a separate proposed rulemaking. That rulemaking addresses entities that are wholly owned by one or more Tribes. As explained in that proposed regulations, such entities will be treated as an applicable entity through treatment as an instrumentality of a Tribe. Entities that are not wholly owned by one or more Tribe and that co-own applicable credit property with an elective pay-eligible entity (or entities) may avail themselves of the Final Rules regarding joint arrangements.

Former Partnerships

A commenter stated that it is not clear whether Treasury intended the proposed section 761 Regulations to: (i) narrowly provide guidance on how a partnership can make a valid section 761(a) election to be excluded from the application of the subchapter K rules (so that the "former partnership" can be treated as an applicable entity for purposes of section 6417 and the 6417 final regulations); or (ii) more broadly exclude the "former partnership" from all aspects of the subchapter K rules. The commenter explained that the latter would appear to disadvantage Tribes and other applicable entities using partnership structures to make investments in applicable credit property that generate applicable credits (as compared to other taxpayers who use similar structures). That is, if the proposed section 761 Regulations more broadly exclude a "former partnership" from all aspects of the subchapter K rules, Tribes and other applicable entities may not be able to, e.g., receive special or disproportionate distributions and allocations of cash, income and loss items, tax credits, etc. ("disproportionate distributions and allocations"), while other taxpayers using partnership structures would continue to maximize their access to tax credits, as the case may be, through similar special or disproportionate distributions and allocations. The commenter asked Treasury to provide additional clarification on how narrowly or broadly Tribes and other applicable entities should construe the proposed section 761 Regulations.

From the commenter's experience as the owner of several entities engaged in or interested in energy production, as written, the elective pay rules and the proposed section 761 Regulations do not sufficiently incentivize private entities to work alongside Tribes. Rather, the increased risk and transaction costs involved in establishing a valid "joint ownership arrangement" rather than a traditional partnership will likely deter outside investors in their view. Even where a private entity is willing to accept the added costs, risks, and logistical complications, the commenter explained that their view is that few private entities can justify foregoing the legal protections and business structure afforded by forming a traditional partnership. Finally, in the unlikely event that a private entity chooses to form a joint ownership arrangement with an applicable entity for the purposes of operating an energy facility, only the applicable entity co-owner will receive a benefit from the arrangement—that is, direct pay of its pro rata share. On the other hand, the private entity co-owner will receive its share of the relevant tax credit in the very same manner it would have had it developed the project by itself.

For these reasons, the commenter urged Treasury to broadly allow "former partnerships" to utilize subchapter K rules, allowing them to receive special or disproportionate distributions and allocations.

Federal Response: If a section 761(a) election is made by an unincorporated organization, under the statute, subchapter K no longer applies to the unincorporated organization. As a result, each member of the unincorporated organization is treated as owning its proportionate share of the property held through the unincorporated organization directly for purposes of subchapter K. Additionally, section 761(a) requires that the members of an unincorporated organization that makes an election to be excluded from the partnership tax rules must be able to determine their income without the necessity of computing partnership taxable income.

Special or disproportionate distributions or allocations violate the existing statutory requirements for electing out of subchapter K, even as modified by the Final Rules. This is because such structures provide members with disproportionate amounts of income, gains, losses, deductions, credits or cash amounts and thereby require an unincorporated organization to compute partnership taxable income to determine each member's share of the organization's income. These arrangements are also incompatible with the 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. For these reasons, the Treasury Department and the IRS clarify that if an unincorporated organization makes a section 761(a) election, the "former partnership" is more broadly excluded from all aspects of the subchapter K rules.

Management Delegation

A commenter asked Treasury to clarify that the managing member of an LLC or the general partner-equivalent should be able to conduct all of the normal project management functions in developing property owned by the organization. This would make it significantly easier for Tribes to manage credit-eligible projects since they could utilize their counterparties' administrative, legal, professional, and project management resources. Put differently, the performance of these functions should not be considered to be pursuant to a delegation of authority by the non-managing members or limited partners but, rather, as inherent in the structure expressly permitted by the proposed regulation. To avoid uncertainty on this point, the commenter requested that the Final Rules expressly state this conclusion.

Federal Response: An applicable unincorporated organization must meet all applicable requirements, including the existing requirements with the modifications contained in the Final Rules, to elect out of subchapter K under section 761(a) and to maintain a section 761(a) election. Generally, the members of an unincorporated organization should be permitted to have a representative to handle management and ministerial duties typical of a managing member of a limited liability company (LLC) or general partner of a limited partnership without violating these requirements. The Treasury Department and the IRS understand that representatives with such duties may be required by local law for entities that would have been permitted to hold the organization's property under proposed §1.761-2(a)(4)(iii)(A). However, the Treasury Department and the IRS decline to provide a "roadmap" for permissible arrangements or rights and duties of such representatives as the list would not be exhaustive and could cause unintentional inferences to be drawn.

Audits

A commenter asked Treasury and the IRS to clarify how audits would happen under the NPRM. Especially for complex Tribal arrangements, the commenter was concerned that auditors may not be familiar with Tribal government structures and policies.

Federal Response: The Final Rules do not provide information about audit procedures or the development of further guidance, but the Treasury Department and the IRS will continue to monitor the elective payment process to determine whether there are areas in which more efficiencies can be created.