

Alert | Energy Project Finance & Development



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IRS and Treasury Department Issue Final and Proposed Regulations Regarding ‘Direct Pay’ Rules Under Inflation Reduction Act and Code Section 6417, Notice Regarding ‘Chaining’ and Revised FAQs

Final Regulations on Direct Pay

On March 11, the Treasury Department and Internal Revenue Service (IRS) issued **final regulations** (Final Regulations) under Section 6417 of the Internal Revenue Code (Code), providing rules for the elective payment of applicable credits under Code Section 6417. Section 6417 of the Code allows certain applicable entities, including tax-exempt and government entities (Applicable Entities), to elect to receive direct payments from the IRS for these credits. In addition, subject to certain limitations, entities that are not Applicable Entities may elect to receive cash payments in lieu of tax credits with respect to Section 45Q carbon capture and sequestration credits, Section 45V hydrogen production tax credits, and Section 45X advanced manufacturing production tax credits. The Final Regulations substantially confirm the previously issued **Section 6417 proposed regulations**, including providing that entities or arrangements classified as partnerships for U.S. federal income tax purposes are not Applicable Entities. Among the differences from the proposed regulations, the Final Regulations provide that a taxable rural electric co-op may qualify as an Applicable Entity for purposes of the direct pay provisions.

The Final Regulations take effect May 10, 2024.

In connection with issuing the Final Regulations, the IRS also updated its elective payment “[Frequently Asked Questions](#).”

Proposed Regulations to Elect Out of Partnership Treatment

As noted above, the Final Regulations do not allow partnerships to qualify as Applicable Entities for purposes of making a direct pay election. Commentors raised concerns in this regard. It is of particular concern where any or all partners in a partnership are Applicable Entities that would have been eligible to elect direct pay if they owned an asset directly, rather than through a partnership. To address these concerns, the Treasury also issued [proposed regulations](#) under Code Section 761 (Proposed Regulations) to provide an exception to certain rules in Treas. Reg. §1.761- 2(a)(3), which enable certain organizations, such as partners in a partnership that are themselves Applicable Entities, to qualify for the direct pay election. Specifically, the Proposed Regulations allow partnerships with partners that are Applicable Entities to elect out of Subchapter K of the Code.

Among other things, to qualify to elect out of Subchapter K of the Code under the Proposed Regulations, the organization must meet four requirements. First, the unincorporated organization must be owned, in part or in full, by one or more Applicable Entities. Second, the unincorporated organization’s members must enter 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 the electricity produced, extracted, or used, or any associated renewable energy credits or similar credits. Third, the unincorporated organization must be organized exclusively for the joint production of electricity from its applicable credit property. Fourth, one or more of the Applicable Entity members must make a direct pay election for its share of the applicable credits.

Comments on the Proposed Regulations must be received by May 10, 2024, and a public hearing on the Proposed Regulations is scheduled for May 20, 2024, at 10 a.m. ET.

Direct Payment of Advanced Manufacturing Investment Credit

Separately, the Treasury Department and IRS also issued [final regulations](#) with respect to the direct payment of the Code Section 48D advanced manufacturing investment credit (Section 48D Final Regulations), which was enacted under the Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act. Section 48D provides for a tax credit equal to 25% for an investment in an advanced manufacturing facility, the primary purpose of which is the manufacturing of semiconductors or semiconductor manufacturing equipment. The Section 48D Final Regulations allow taxpayers to receive a direct payment of the Section 48D credit and provide for special rules applicable to partnerships and S corporations.

Like the Final Regulations, discussed above, the Section 48D Final Regulations take effect May 10, 2024.

Notice 2024-27 Regarding ‘Chaining’

Although prohibited under the Final Regulations, the IRS also issued [Notice 2024-27](#), seeking specific comments on whether “chaining” should be permitted. Chaining is described in the notice as an Applicable Entity electing direct pay for a tax credit acquired in a Section 6418 transfer. Written comments should be submitted by Dec. 1, 2024.

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