Key Changes to Tax Incentives for Municipal Energy Projects

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Since 2022, tax-exempt entities like municipalities have been eligible to receive a refund of a portion of their clean energy project costs. This is accomplished through a mechanism known as Direct or Elective Pay. Elective Pay involves completing your project following federal guidance and filing a few forms with the IRS. Both small and large Vermont municipalities have used Elective Pay successfully and received refunds.

On July 4, 2025, the One Big Beautiful Bill Act (OBBBA) was signed into law, significantly reshaping the landscape of federal energy tax credits. While the bill primarily targets businesses and individuals, several provisions directly affect local governments and municipal energy initiatives. This resource outlines key changes, deadlines, and eligibility modifications relevant to municipalities that are planning clean energy projects or infrastructure upgrades.

Key Changes Affecting Municipal Projects

Accelerated Phase-Out, Phase Down, and Sunset of Clean Energy Incentives

- **Solar and wind projects using the Clean Electricity Tax Credit (Sections 45Y and 48E) have earlier deadlines:**
  - Construction must begin by July 4, 2026. If it begins July 5, 2026, or later, those projects must be placed in service no later than December 31, 2027.
  - Projects that begin construction before July 4, 2026, are *grandfathered*, but these projects must continue uninterrupted construction and be completed within 4 calendar years to retain eligibility for the full credit.
- **For other clean energy technologies (e.g. geothermal, energy storage):**

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    - Technology-neutral credits remain available if construction begins by December 31, 2032.
    - These credits then phase down annually from 2033 to zero by January 1, 2036.
- **For commercial clean vehicles (Section 45W):**
    - Vehicles must be acquired by September 30, 2025.
    - Applies to government fleets.
- **For EV charging infrastructure (Section 30C):**
    - Projects must be placed in service by June 30, 2026.

Restrictions on Foreign-Sourced Materials

- Starting January 1, 2026, municipalities must ensure that a minimum percentage of project costs come from non-prohibited foreign entities (e.g. entities with ties to China, Russia, Iran, or North Korea) sources. This includes components, subcomponents, and critical minerals. The Treasury will release guidance by December 31, 2026, to help determine compliance. Guidance released to date includes Notice 2025-08, which primarily addresses solar components, domestic solar wafers, and battery electric storage systems.
- Projects that begin construction on or before December 31, 2025, are exempt from the restrictions, so meeting that date helps avoid uncertainty.

Future Treasury Guidance

An Executive Order dated July 7, 2025, instructs the Treasury to issue tighter guidance on "beginning of construction" tests and enforce Foreign Entity Of Concern restrictions more strictly. Agencies must respond within 45 days of the order. Municipalities should monitor these developments carefully.

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Update: Notice 2025-42 addresses Beginning of Construction requirements.

Action Steps for Municipal Officials

- Fast-track any planned solar or wind projects so construction begins by December 31, 2025, ideally, or at least by July 4, 2026.
- Aim to begin construction by end of 2032 for other clean energy types (battery storage, geothermal, etc.).
- Vet suppliers rigorously to avoid components or services tied to restricted foreign entities - especially for projects starting after December 31, 2025.
- With EV or charging plans, ensure acquisitions/services occur before Sept 2025 (vehicles) and before June 2026 (charging stations).
- Use the elective (direct) pay option to monetize credits even without federal tax liability. Vermont municipalities, big and small, have been refunded a portion of their project costs through this option.

Municipalities that want to use Elective/Direct Pay for a project refund must prioritize project timelines over the fall of 2025, given accelerated phase-outs and new foreign supply constraints. Early planning, compliance documentation, and close attention to guidance from both the Department of Energy and IRS will be critical to preserving access to tax credit benefits for local government infrastructure and energy upgrades.

Have additional questions?

To learn more about elective pay and how to claim a tax credit for a municipal project, visit:

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- Detailed Overview of Elective Pay Credit - Lawyers for Good Government – This recording from the Vermont Bond Bank's 2024 Capital Planning Forum provides more detail about elective pay, the filing process, and documentation.
- Elective Pay & IRA Tax Incentives - Lawyers for Good Government – Fact sheets for first-time tax credit claimants, annotated forms that help you understand and complete IRS forms, webinars, and searchable Frequently Asked Questions. You can submit questions that L4GG will answer through its Frequently Asked Questions.
- Elective pay and transferability - Internal Revenue Service – Main IRS webpage about elective pay for official information.
- Elective pay and transferability frequently asked questions - Internal Revenue Service – Good for exploring the most common questions about elective pay and pre-filing registration.
- Catalyzing Local Clean Energy – A Roadmap for Maximizing Inflation Reduction Act Opportunities and Community Benefits – National League of Cities – The tables in this 55-page publication are worth a glance if you have questions.

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