IRS Tightens Timeline for Energy Tax Incentive Eligibility: What Municipal Leaders Need to Know

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The IRS has released **new guidance on the "beginning of construction" requirements for wind and solar facilities** in relation to the termination of clean electricity production credits (section 45Y) and clean electricity investment credits (section 48E). Municipalities can use both of these tax incentives for **wind and solar projects if a project begins construction before July 5, 2026**

Definition of "Beginning Construction"

IRS Notice 2025-42 tightens the criteria for when a wind or solar project is considered to have begun construction. There are now two key requirements:

1. **Physical Work Test** - You must start **physical work of a significant nature** on the project. Examples include excavation, installation of foundations or mounting structures, and on-site or off-site fabrication of custom components. Planning, permitting, environmental reviews, or purchasing standard inventory items are not considered a demonstration of "beginning construction". Third party purchases must have a binding written agreement (contract) to meet the physical work test.
2. **Continuity Requirement** - After starting construction, you must maintain **continuous progress**. Temporary delays (e.g., weather, permitting, interconnection issues) are acceptable if properly documented. If the facility is placed in service within **four years** of the construction start date, continuity is presumed.

Key Changes from Prior Guidance

Prior IRS guidance had permitted clean energy facilities (including wind and solar projects) to use a *safe harbor* under which construction was considered to have

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begun if an entity claiming the credit had paid or incurred 5% or more of the total cost of the facility (the 5% Safe Harbor). IRS Notice 2025-42 limits use of the 5% Safe Harbor by wind and solar facilities to low-output solar facilities, defined as facilities with an output no greater than 1.5 MW.

The "continuous efforts" standard has been replaced with a stricter "continuous construction" requirement.

Do These Changes Apply to My Town's Project?

The new guidance applies to projects that begin construction on or after September 2, 2025.

Wind and solar facilities that are not impacted by this guidance are facilities that:

- begin construction prior to September 2, 2025 (including those that satisfied the 5% Safe Harbor prior to such date),
- are placed in service by December 31, 2027, or
- qualify as low-output facilities (output no greater than 1.5 MW).

In addition, other types of clean energy facilities (e.g., nuclear and battery storage) are not directly impacted by the guidance.

Planning Considerations for Municipal Projects

While most Vermont municipalities construct low-output solar facilities, to ensure eligibility of your project for the tax incentives:

- **Document physical work**: Keep records of contracts, invoices, and photos showing construction activity.

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- **Track timelines**: Aim to place facilities in service within four years of starting construction.
- **Coordinate early**: Engage contractors and permitting agencies well ahead of July 2026.
- **Consult professionals**: Tax advisors and legal counsel can help interpret the rules and safeguard compliance.

To qualify for federal energy tax credits, your project must begin construction before July 5, 2026, and be placed in service by December 31, 2027. Projects that miss these deadlines will not be eligible for the credits due to phase-out provisions in the *One Big Beautiful Bill Act.*

For full details, you can review Notice 2025-42 on the IRS website.

Additional guidance related to clean energy projects and use of the tax incentives is anticipated.

Have additional questions?

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

- 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.

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- 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.

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