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Tax Credit Implications of the One Big Beautiful Bill Act

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On May 22, the U.S. House of Representatives passed an amended version of H.R. 1—the One Big Beautiful Bill Act (the Bill) — by a vote of 215-214. The House-passed version of the bill, slated to be considered by the Senate this month, includes significant changes to the timing and availability of several clean energy tax credits, including the clean energy ITC (CEITC) and PTC (CEPTC), the clean hydrogen PTC, the advanced manufacturing credit, and the zero-emission nuclear PTC. The Bill also introduced restrictions related to foreign entities applicable to such credits and to the carbon capture sequestration credit. While it is expected that the Bill will undergo additional changes before potential approval by the Senate, the Bill includes significant changes as compared to current law and short timeframes for potentially grandfathering renewable energy projects from such changes. Developers and other affected taxpayers should be aware of these potential changes and endeavor to begin construction of projects before the relevant effective dates, as described below.

Key Changes

In this advisory we discuss four key changes that will have a significant impact on the renewable energy industry:

- Accelerated phase out of various clean energy tax credits;
- New restrictions related to foreign entities of concern (FEOC);
- Denial of CEITC and CEPTC for residential solar and wind; and
- Repeal of transferability for some clean energy tax credits.

Accelerated Phase Out/Sunset of CEPTC, CEITC, Nuclear PTC, Clean Hydrogen PTC, and Advanced Manufacturing Credits

The Bill would accelerate the phase out of various clean energy tax credits. Under current law, the phase-out period for the CEPTC under Section 45Y and the CEITC under Section 48E would commence upon the later of 2032 and the year in which greenhouse gas emissions from electricity production have been reduced by 75% from 2022 levels. Once it commences, the phase-out period would occur over three calendar years. The Bill would remove the phase-out period, requiring that projects *both* begin construction within 60 days of the enactment of the Bill, *and* be placed in service by December 31, 2028 to qualify for the CEITC or the CEPTC. The only exception under the Bill is for “advanced nuclear facilities,” defined by reference to Section 45J of the Code, which must begin construction or expansion by December 31, 2028 to be eligible for the CEITC or CEPTC.

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- Troutman Pepper Locke Insight: The 60-day “beginning of construction” standard is much shorter than the industry hoped. If passed as is, it would be a severe disruption to the renewable energy industry. Trade groups are likely to prioritize getting a longer timeline for this transition rule in their discussions with lawmakers.

The Section 45V clean hydrogen PTC is currently scheduled to be phased out for all qualified clean hydrogen production facilities if construction does not begin before January 1, 2033. The Bill would accelerate that date by seven years to January 1, 2026.

- Troutman Pepper Locke Insight: It is unlikely that many clean hydrogen projects will be able to meet that beginning of construction deadline, given that the industry is still nascent. Most developers are not yet able to procure significant equipment or begin physical work on their clean hydrogen projects.

The Section 45X advanced manufacturing credit applies different credit rates to the production of different components. Under current law, the Section 45X credits are set to begin phasing out at the beginning of 2030, with complete phase-out for components sold after 2032. The Bill would accelerate the complete phase-out to the end of 2031 for all eligible components with the exception of wind energy components, which would not be eligible for the credit if components are sold after December 31, 2027.

- Troutman Pepper Locke Insight: The earlier phase-out for wind components is consistent with the Administration’s other policies, including a presidential memorandum targeting wind energy and an order to stop work on the Empire Wind 1 Project.

With respect to the Section 45U nuclear PTC, the Bill accelerates the termination date by one year, such that the credit would not be available for electricity produced and sold in taxable years beginning after December 31, 2031.

- Troutman Pepper Locke Insight: The Bill originally included a harsher phase-down of the Section 45U nuclear PTC. The favorable change to the Bill indicates that the nuclear industry is favored by the current Republican majority.

Restrictions on Foreign Entities and Investors

The Bill introduces complex restrictions related to relationships with or assistance from certain foreign entities of concern (FEOCs), which apply to the CEITC, CEPTC, the carbon capture sequestration credit, the nuclear PTC, and the advanced manufacturing credit.

For facilities that begin construction after December 31, 2025, no credit is available if the facility is owned by a “specified foreign entity” (SFE). An SFE is defined in the Bill to include specifically identified threats to the security of the U.S., Chinese military companies operating in the U.S., entities subject to Uyghur Forced Labor Prevention Act restrictions, and battery-producing entities eligible for Department of Defense contracts as identified by the National Defense Authorization Act for Fiscal Year 2021.

- Troutman Pepper Locke Insight: This definition includes Contemporary Amperex Technology Company (CATL), BYD Company, Envision Energy, EVE Energy Company, Gotion High Tech Company, and Hithium Energy Storage Company, thus impacting significantly all battery energy storage systems.

SFEs also include foreign-controlled entities. An entity will generally be a “foreign-controlled entity” only if it is

owned more than 50% by entities with ties to North Korea, China, Russia, or Iran.

In addition, for facilities that begin construction more than two years after the enactment of the Bill, no credit would be allowed if the facility is owned by a "foreign-influenced entity" (FIE). An FIE is one that satisfies a two-pronged test: first, one of the following conditions must be met: (i) an SFE has authority to appoint a covered officer, (ii) a single SFE owns at least 10% of the entity, (iii) one or more SFEs own in the aggregate 25% or more of the entity, or (iv) at least 25% of the entity's debt is held in the aggregate by one or more SFEs. Second, the entity must knowingly make (or have reason to know that it is making) any fixed, determinable, annual or periodic (FDAP) payment (including dividends, interest, or compensation for services, rentals or royalties) to one of the aforementioned entities that is (i) greater than or equal to 10% of the total of such payments made by the entity during the taxable year, or (ii) greater than or equal to 25% of the total of such payments in the aggregate during the taxable year.

The Bill would apply the FEOC ownership rules (subject to the transition rules described above) to the old ITC under Section 48 of the Code, but not to the old PTC under Section 45 of the Code.

- Troutman Pepper Locke Insight: It is not clear why the Bill would apply some, but not all, of the FEOC rules to the old ITC. The application of some FEOC rules to the old ITC but not the old PTC is presumably due to the applicability of the old ITC to geothermal heat pump property, which is eligible for the old ITC if construction begins before January 1, 2035 under current law, or before January 1, 2032 under the Bill.

In addition to the ownership-related restrictions described above, new project-level restrictions would prevent facilities from being eligible for the CEITC, CEPTC, or advanced manufacturing credits if they begin construction after the end of 2025 (or two years after the date of enactment in the case of the advanced manufacturing credits) and receive "material assistance from a prohibited foreign entity" (PFE). A PFE is an SFE or an FIE. The term "material assistance" from a PFE means, with respect to any property —

(i) any component, subcomponent, or applicable critical mineral included in such property that is extracted, processed, recycled, manufactured, or assembled by a PFE, or

(ii)any design of such property which is based on any copyright or patent held by a PFE or any know-how or trade secret provided by a PFE.

Carve-outs are included for parts, subcomponents, or constituent materials that are not exclusively or predominantly produced by and acquired from a PFE and uniquely designed for use in construction of an ITC, PTC, or advanced manufacturing credit facility.

- Troutman Pepper Locke Insight: As a result of the material assistance rule and the broad reach of the definition of PFE, it would appear that almost no battery storage systems would be eligible for the ITC unless construction begins within 60 days of enactment of the Bill, unless the Senate makes changes to either the scope of the FEOC rules or the transition dates. The material assistance rule is also expected to impact nearly all major suppliers of solar modules. The transition dates for the FEOC rules themselves, at least in the context of the ITC and PTC, are largely irrelevant given the 60-day beginning of construction requirement for the credits themselves. The fact that the House retained the separate beginning of construction effective dates for the FEOC rules may indicate that they expect the Senate to provide relief of the transition rules with respect to the credits themselves.

For taxable years beginning after the date that is two years following the enactment of the Bill, the existence of FDAP payments made to one PFE equal to or greater than 5% of the total of such payments during the taxable year, or to more than one PFE equal to or greater than 15% of the total of such payments during the taxable year, would result in ineligibility for or recapture of the credits.

- Troutman Pepper Locke Insight: The payment rule would impose an extraordinary compliance burden on taxpayers. A taxpayer would need to categorize every payment that it made during the taxable year as being either FDAP or not FDAP, and then determine for every FDAP payment whether the recipient was a PFE or not a PFE. Even inadvertent violations of the rule (e.g., resulting from misrepresentations of a payment recipient) would be punished.

The Bill would amend the recapture rules for the CEITC to provide that payments to FEOCs would result in recapture of the CEITC. However, unlike the normal ITC recapture rules, this FEOC recapture rule would apply during the 10-year period beginning at placed in service, and would result in 100% recapture at all points during that period.

Denial of Credit for Expenditures for Wind and Solar Leasing Arrangements

The Bill targets the residential solar industry by denying an CEITC or CEPTC to residential solar or wind generation property or residential solar water heating property if the taxpayer rents such property to a third party and the lessee would qualify for an individual tax credit under Section 25D if it owned such property.

Repeal of Transferability

Finally, the current version of the Bill would repeal transferability of certain tax credits, including the carbon oxide sequestration credit, the advanced manufacturing credit, and the Section 45Z clean fuel PTC. We note that an earlier version of the Bill included repeal of transferability for other credits, including the ITC and PTC, as well, if construction of the facilities began two years after enactment of the Bill. The specific repeal of transferability with respect to such credits was presumably dropped from the Bill due to the accelerated sunset dates for the credits themselves, and could be reintroduced in the Senate bill if longer sunset dates are included. Note, however, that the repeal of transferability for the ITC for geothermal energy projects was not removed.

- Troutman Pepper Locke Insight: The transferability market has been robust since the passage of the Inflation Reduction Act of 2022; repeal of transferability would result in a significant loss of a financing tool that has been critical to many renewable projects throughout the U.S.

Conclusion

These changes may impact current and future investments in energy-related projects. We recommend reviewing these updates in detail to understand their implications on operations and tax planning strategies, and to the extent possible, beginning construction on planned facilities as soon as possible. (However, we note that even though the IRS “beginning of construction” guidance has existed for more than a decade, and there are numerous strategies for satisfying that guidance that are well-established, the applicable guidance is subject to change by Congress or the IRS.)

For further assistance or clarification, please contact any of the authors of this advisory.

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