Simpson Thacher

Memorandum

Senate Bill Pulls Some Punches, but Would Still Phase Out Tax Credits for Future Clean Energy Projects

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On June 16, 2025, the Senate Finance Committee released its first draft of budget reconciliation legislation in response to H.R. 1, the "One Big Beautiful Bill Act" (the "Bill"), passed by the House of Representatives on May 22, 2025. The Senate version of the Bill is responsive to many of the comments that the House version has drawn from developers and investors in the clean power sector.

With respect to U.S. federal income tax credits available for clean energy projects, some of the highlights of the Senate version of the Bill include:

- No retroactive clawback of tax credits for projects that are currently operational or now under construction would apply.
- Phase-out of the U.S. federal production tax credit ("PTC") and investment tax credit ("ITC") that allows grandfathering based on when a project begins construction, an improvement on the position in the House version of the Bill, which would have imposed a requirement that projects be "placed in service" prior to December 31, 2028 in order to qualify for tax credits.
- The PTC and ITC for wind and solar energy projects would be phased out over three years (40% reduction in 2026 and 80% reduction in 2027) with projects that begin construction in 2028 or later no longer being eligible. Battery, hydropower, geothermal, and other electricity-generating projects with zero lifecycle greenhouse gas emissions would remain eligible for the full amount of credits as long as they begin construction before 2034.
- Any entitlement to bonus credits (or "adders") for qualifying projects would be preserved, including the "energy community" adder and the "domestic content" adder.
- Transferability of tax credits has been retained (subject to new limitations on transfers to certain foreign entities).
- Restrictions on projects owned by or receiving material assistance from foreign entities of concern and other entities subject to foreign ownership or influence from the House version of the Bill have been clarified, but not removed.

Although further changes can be expected as the draft moves through committee to the Senate floor, the Senate version of the Bill is an encouraging starting point for future negotiations.

Proposed Changes to the PTC & ITC

CURRENT LAW

Under the Inflation Reduction Act of 2022 (the "IRA"), a 10-year PTC is available for certain facilities that generate electricity with zero net greenhouse gas emissions, which can include both wind and solar energy facilities. An ITC equal to a percentage of a taxpayer's investment in such facilities, as well as in property used for the storage of electricity, hydrogen, or thermal energy ("energy storage technology" or "EST"), is also available. Under the IRA, the PTC and the ITC are each subject to a gradual phase-out that would begin for facilities and EST that start construction two calendar years after the year in which annual U.S. greenhouse gas emissions from the production of electricity are 25% or less of their 2022 level (but in no case earlier than 2032).

In addition, in lieu of claiming the PTC or the ITC, the IRA permits certain taxpayers to transfer the credits by selling them to another taxpayer in exchange for a payment in cash or cash equivalents.

ACCELERATED PHASE-OUT SCHEDULE IN THE SENATE VERSION

The Senate version of the Bill would adopt a two-track phase-out schedule for the PTC and the ITC: one schedule for solar and wind projects and a separate schedule for EST (including EST placed in service at a solar or wind facility) and clean electricity generation projects that rely on other technologies (*e.g.*, nuclear and hydroelectric).

Phase-out Schedule for Solar & Wind

If construction begins in...	...the percentage of the credit allowed is:
2025 or earlier	100%
2026	60%
2027	20%
2028 or later	Credit Eliminated

Phase-out Schedule for EST & Other Technologies

If construction begins in...	...the percentage of the credit allowed is:
2034 or earlier	100%
2035	75%
2036	50%
2037 or later	Credit Eliminated

The phase-out schedule in the Senate version of the Bill is more generous than the House version, which generally would have eliminated the PTC and the ITC for new projects that (i) begin construction more than 60 days after the date the Bill is enacted into law or (ii) are placed in service after December 31, 2028. The principal benefit of removing the placed-in-service requirement is that tax credit eligibility would not be affected by any construction delays, as long as the "begun construction" test is satisfied.

Both the House and Senate versions of the Bill would eliminate, beginning in 2026, the PTC and ITC for residential solar leases, though this change is expected to practically impact only a small number of states whose laws impede rooftop solar companies from directly entering into power purchase agreements with customers (and where leasing is therefore more prevalent as an alternative). This prohibition would also apply to residential wind leases.

BONUS CREDITS PRESERVED

Under both the House and Senate versions of the Bill, any entitlement to bonus credits (or "adders") for qualifying projects would be preserved, including the "energy community" adder and the "domestic content" adder. Unlike the House version of the Bill, the Senate version does not include a provision that would cut off the ITC low-income community bonus credit program after 2028.

TRANSFERABILITY GENERALLY PRESERVED

The Senate version of the Bill preserves the ability of taxpayers to sell PTCs and ITCs, as well as the tax credits discussed in the following section. However, as discussed later in this memorandum, for certain tax credits, including the PTC and ITC, a "prohibited foreign entity" (as defined below) would be an ineligible credit purchaser. This limitation would not affect the transfer of PTCs and ITCs with respect to projects that began construction prior to 2025 and qualify for the pre-IRA versions of the credits under Sections 45 and 48 of the Internal Revenue Code (the "Code").

Proposed Changes to Other Tax Credits

EXTENSION FOR CLEAN TRANSPORTATION FUELS

Under the IRA, a clean fuel production tax credit under Code Section 45Z (the "45Z credit") is available for sales of clean transportation fuels, including sustainable aviation fuel, that occur between 2025 and 2027. A preferential credit amount applies to sales of sustainable aviation fuel that is greater than the standard credit amount that applies to sales of other clean transportation fuels.

Both the House and the Senate versions of the Bill would extend the 45Z credit for sales of sustainable aviation fuel and other clean transportation fuels through 2031 but, under the Senate version, sales of sustainable aviation fuel produced after 2025 would no longer be eligible for the preferential credit amount and would instead receive the same credit amount as sales of other clean transportation fuels. Further, under both versions the criteria for the lifecycle greenhouse gas emissions analysis used to determine eligibility for the 45Z credit appear to be more generous than under the IRA.

The Senate version of the Bill does not include the provision in the House version that would have required, as a condition to qualify for the 45Z credit, that the fuel be "exclusively" derived from feedstock produced or grown in the United States, Mexico, or Canada. Instead, the Senate version opts for a partial phase-out of the credit that would depend on what proportion of the feedstock was produced or grown outside of the United States.

The Senate version of the Bill would also eliminate the current federal excise tax credit for sustainable aviation fuel, effective for sales occurring after September 30, 2025.

PHASE-OUT OR ELIMINATION OF OTHER CREDITS

The Senate version of the Bill would eliminate several other credits relating to electric vehicles ("EV") and their related infrastructure. The Code Section 30D credit (for buyers of new clean vehicles) and the Code Section 45W credit (for buyers of commercial clean vehicles) would be eliminated for vehicles purchased more than 180 days after the date of enactment. The Code Section 30C credit (for installation of EV charging stations) would be eliminated for property placed in service more than 12 months after the date of enactment.

The Senate version of the Bill would phase out the advanced manufacturing production credit under Code Section 45X for the production of "applicable critical minerals" at a rate of 25% per year beginning in 2031. Sales of other "eligible components" would remain eligible for the Code Section 45X credit according to the existing phase-out schedule under the IRA, with the exception of wind energy components, for which the credit would be eliminated for sales occurring after 2027. The Senate version would also eliminate the ability of affiliated taxpayers to "stack" the Code Section 45X credit by selling an "eligible component" to a related taxpayer which then incorporates it as a component of a different "eligible component" that is sold to an unrelated party.

Consistent with the House version, the Senate version would eliminate the production and investment tax credits for hydrogen facilities for projects that begin construction after 2025.

Restrictions on Transactions with Foreign Entities

The House version of the Bill included provisions intended to address the direct and indirect reliance of the clean energy industry on the Chinese supply chain by prohibiting taxpayers that engage in certain transactions with foreign entities from claiming new tax credits. While the Senate version maintains these provisions, it also narrows their scope, clarifies the requirements, and adopts what appear to be more practically workable tests. Nevertheless, demonstrating compliance with these requirements can still be expected to mean a substantial amount of paperwork for developers.

These prohibitions fall into two categories: (1) restrictions related to ownership, funding and services (the "prohibited foreign entity" restrictions) and (2) restrictions related to procurement and construction (the "material assistance" restrictions).

PROHIBITED FOREIGN ENTITIES

For taxable years beginning after the date of enactment of the Bill, a taxpayer would be ineligible to claim the PTC or ITC if it is a "specified foreign entity" or a "foreign-influenced entity" (together, "prohibited foreign entities"). The Senate version of the Bill generally maintains the definition of "specified foreign entity" from the House version, which generally would include "foreign entities of concern" (and certain other foreign companies identified as problematic under federal statutes) as well as the governments of China, Iran, North Korea, and Russia, citizens of and entities organized in those nations, and any other entity that is controlled by any of the foregoing.

On the other hand, the Senate version of the Bill narrows the definition of “foreign-influenced entity” relative to the House version. Under the Senate version, two alternative tests would apply to determine foreign-influenced entity status. Under the first test, a taxpayer would be a foreign-influenced entity if, in the relevant taxable year, a specified foreign entity has the authority to appoint a board member or executive-level officer or owns 25% or more of the equity of the taxpayer, or if a combination of specified foreign entities own 40% or more of the equity or 40% or more of the debt of the taxpayer in the aggregate. A more lenient version of this test would apply to taxpayers that are publicly traded entities.

Under the second test, a taxpayer would be a foreign-influenced entity if, during the preceding taxable year, it made a payment to a specified foreign entity pursuant to a contract or other agreement that entitles the specified foreign entity to exercise “effective control” over a project. While the Senate version contains interim guidance as to the meaning of “effective control,” the ultimate definition of that term would be delegated to the Treasury Department to clarify by regulation.

The prohibited foreign entity restrictions would also apply to the Code Section 45X credit and the carbon sequestration credit under Code Section 45Q. The restrictions would apply to the 45Z credit and the nuclear power credit under Code Section 45U on a staggered basis, with such restrictions taking effect for specified foreign entities for taxable years beginning after the date of enactment and for foreign-influenced entities for taxable years beginning more than two years after the date of enactment. Additionally, beginning in 2026, prohibited foreign entities would be ineligible to purchase any of these credits, as well as PTCs and ITCs (provided that, with respect to the 45Z credit and the nuclear power credit under Code Section 45U, a foreign-influenced entity could continue to purchase such credits until the staggered effective date mentioned above).

None of the prohibited foreign entity restrictions just discussed would apply to the pre-IRA versions of the PTC and ITC under Code Sections 45 and 48 that apply to projects that began construction prior to 2025.

MATERIAL ASSISTANCE

The material assistance restrictions would apply only to projects that begin construction after 2025. Under these rules, no tax credit would be allowed (to any investor in such a project) if the project receives material assistance from a prohibited foreign entity.

The Senate version of the Bill introduces a concept of “material assistance cost ratio,” which would be based on the taxpayer’s input costs attributable to manufactured products that are not produced by prohibited foreign entities relative to the total input costs attributable to all manufactured products included in the project. If the ratio does not meet a threshold level (which would gradually step up each year from 2026-2030), the project would be ineligible for a PTC or ITC. At the election of the taxpayer, the cost of manufactured products acquired pursuant to a binding written contract entered into prior to June 16, 2025 and placed in service prior to January 1, 2030 would be excluded from the calculation of the material assistance cost ratio. This is an improvement to the House version of the Bill—which would have in some cases rendered a project ineligible if even a single component were sourced from a prohibited foreign entity—and reflects the market reality that a significant proportion of renewable energy equipment relies heavily on parts manufactured in China.

Taxpayers would be permitted to rely on certifications provided by suppliers that a given manufactured product was not produced by a prohibited foreign entity. To enforce compliance, the Senate version would impose penalties on suppliers that provide false or inaccurate certifications. Taxpayers should also take note that the statute of limitations for audit with respect to the material assistance rules would be six years instead of the usual three.

The material assistance restrictions would apply to the versions of the PTC and ITC under Code Sections 45Y and 48E, but not to the pre-IRA versions of the credits under Code Sections 45 and 48 applicable to projects that began construction prior to 2025. They would also apply to the Code Section 45X advanced manufacturing production credit, with the material assistance cost ratio in such case being based on direct material costs for the production of the relevant "eligible component" (subject to the same election described above to exclude the cost of certain constituent materials and subcomponents acquired pursuant to a binding written contract).

FUEL SOURCING FOR NUCLEAR PROJECTS

Under rules similar to the material assistance rules, a nuclear project generally would be ineligible for the production tax credit under Code Section 45U in any taxable year beginning after 2027 if it uses any fuel produced in China, Iran, North Korea, or Russia or by an entity organized in one of those countries.

Observations

IMPLICATIONS FOR EXISTING PROJECTS

Because the Senate version of the Bill would phase out the PTC and ITC on a prospective basis, projects that are currently operational or that have begun construction would remain eligible for the PTC and the ITC as well as for the credit transferability provisions of the IRA. However, unless a project began construction before 2025 and qualifies for the pre-IRA PTC and ITC (under Code Sections 45 and 48), owners of the project would still be subject to the Bill's new prohibited foreign entity restrictions and could become ineligible to claim the tax credits in future taxable years after such restrictions take effect.

IMPLICATIONS FOR NEW PROJECTS

The more gradual phase-out under the Senate version of the Bill reduces some of the immediate urgency for projects to seek grandfathered status under the House version, which generally would have eliminated the PTC and ITC for projects that did not start construction by 60 days after the date of enactment. However, to continue to be eligible for the maximum possible credit, it may still be advisable for investors and developers to start planning for how to grandfather projects in development through the start of construction safe harbor, which requires a taxpayer to either (1) begin physical construction on site or (2) incur 5% of expenditures with respect to a project. Projects that do not begin construction by December 31, 2025 will see some or all of their credits phased out and, moreover, will be subject to the material assistance restrictions described above.

IMPLICATIONS OF FOREIGN TRANSACTION PROHIBITIONS ON EXISTING AND NEW PROJECTS

While the prohibitions on foreign ownership and assistance contained in the Senate version of the Bill are no less complex than those contained in the House version, they clarify the criteria for compliance, which would contribute to additional certainty for developers and investors. Nevertheless, the Senate version still leaves many open questions that would need to be clarified by regulations and other guidance following enactment. U.S. investors and developers are advised to speak to their tax advisors on how these new prohibitions may apply to them.

We Can Help

Simpson Thacher is actively monitoring the progress of the Bill and its implications for the clean energy sector and its investors.

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