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After OBBBA, What's Next for Clean Energy Tax Credits? Here are Some Considerations - Novogradac

The only constant is change. It's inevitable.

Policy and legislation changes shaping the current energy landscape will require renewables to adapt. The increasing need for new generation after decades of relatively flat demand growth will also drive changes. The ability of renewable energy stakeholders to provide more timely and cost-effective solutions will keep clean power in the mix, albeit at a slower pace of uptake, at least in the immediate future.

At the same time, the climate will continue to be an existential issue and the United States needs steady jobs and resilient sources of clean energy. We will inevitably have the opportunity to change, reinvent or resurrect tax credits and other public incentives for renewable energy solutions. How should we use lessons learned from both the Inflation Reduction Act (IRA) of 2022 and the One Big Beautiful Bill Act experiences to inform future strategy?

We offer a few thoughts and considerations:

Consider Partnering with Other Energy Markets (e.g., Oil and Gas) to Protect the Concept of Public Support for Public Goods, Including Reliable Energy

An effective partnership with oil and gas players would enable renewables to be viewed as complementary to baseload technologies and an important part of economic and energy security. It would also undercut the argument that renewables are too mature to warrant continued support. If the fossil industry receives financial support, renewables should too. Given that many "big oil" players are already invested in renewable companies, this may be a real possibility.

Consider the Rate at Which Tax Credits are Still Effective But are More Manageable for Budget and Messaging

Tax credits had a much more robust impact in the context of a 35% corporate tax rate. With the current corporate rate at 21% and many corporations unwilling to go lower than an effective tax rate of 15%, the demand for tax credits is not unlimited.

Constrained access to tax investors may be more acutely felt in middle-market deals. The added value and volume of tax investing after the IRA was and is highly concentrated in storage systems, very large installations and manufacturing plants.

Further, the credit adders increase the difficulty of finding budget "pay-fors" at the federal level and may increase unwanted political attention. The domestic content adder seems redundant in the face of FEOC requirements, and it is unclear that any of the "community" adders had the desired impact on communities, in large part due to the time needed to develop sites to the federal requirement and limited bandwidth at the IRS to review applications.

We suggest a smaller credit is more sustainable in the long run. A flat rate of approximately 25% may be a good compromise. It is more in line with other community development credits and would reduce the 10-year outlay for budget discussions while still promoting renewable uptake.

Broaden the Focus for Incentives and Support to More Than Tax Credits

Federal tax credits are but one of the incentives needed to move the market. State-based and regional programs have had great success. Renewable portfolio standards, community solar access, net metering and storage incentive programs are good examples.

The ability to transmit and deliver power is critical to all generating sources. The grid desperately needs investment to address access and reliability. Regional system operators and the Federal Energy Regulatory Commission should be targets of collective lobbying to encourage progress.

The federal, state and local requirements for construction permitting, interconnection and environmental reviews should be streamlined. Recent changes to the National Environmental Policy Act rules may help. An expansion of the Public Utility Regulatory Policies Act rules around priority dispatch to encompass installations larger than 5 MW would give some comfort to investors that small and medium deals have sales options for their power into the future.

The renewable community should support state and public utility programs that allow for net metering, protect renewable dispatch, guarantee access to transmission and delivery, and give benefits to low-income households.

In addition, a simplification of the federal accounting treatment for partnership investments would ease a barrier to entry for investors and developers alike. The recent introduction of proportional amortization was intended to help, but arguably made the rules more complex.

Review Experience with Various Tax Investing Structures

The current policy allows a range of investments to monetize renewable credits. This flexibility has proven useful for projects of varying sizes and market segments, each with distinct financing needs. We think the range of options should remain.

The options vary in terms of timing, return and complexity. At one end of the spectrum are sale-leasebacks, wherein the investor buys the entire project for a defined period. Then there are partnerships where ownership is shared and benefits are allocated on a negotiated split and for a defined period of time. The proportional amortization (PAM) option for partnership accounting became possible due to Financial Accounting Standards Board changes. PAM essentially allows the investor to buy into the value of tax credits and depreciation, but not cash, and can be rigid to implement. Finally, the transfer option is a straightforward purchase of the credits only—no cash or depreciation. As you progress through these options, the Generally Accepted Accounting Principles accounting gets simpler and returns decline.

Market reactions over the past two years show that simplicity sells, especially at scale. Large investors looking to offset large tax positions trend almost exclusively to transfers, irrespective of lower returns. Investors looking for a more engaged option with higher returns may still invest in individual projects and portfolios of commercial and industrial and community solar through the sale-leaseback or partnership structures. The hybrid or T-flip structure allows for short-term equity (i.e., less than 10 years) to invest and then sell some or all the credits and depreciation. But the hybrid still ultimately relies on investors with tax appetite and may require a complex set of documents.

In summary: To achieve progress on practical, sustainable and effective public incentives for renewable energy, it's essential to find the right balance of messaging, simplicity, coverage and return potential within an "all-of-the-above" power market.

There are certainly additional strategies and actions worth considering. We encourage all stakeholders to look forward to the future development of the energy market.

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