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Renewable Energy Project Credit Payments: Action Required

The federal government currently provides *elective pay* tax credit payments ("project payments") to public agencies to finance renewable energy projects. Elective pay credits allow tax-exempt entities to receive funding for renewable energy projects by claiming the payment as part of their annual tax return. The IRS then processes a refund payment to the agency in the amount of the credit. These credits can help finance wind, solar, energy storage, hydropower, geothermal, nuclear, and fuel cell projects.

The budget enacted by Congress in July 2025 (Act) terminates project payments for wind and solar projects starting operation after December 31, 2027. However, this termination **does not apply** to projects that "begin construction" by **July 4, 2026**.[1]

The IRS explains that "beginning of construction" can be demonstrated in the earlier of two ways: the "physical work" test and the "safe harbor" test. The "physical work" test requires that significant construction activities be underway, such as excavation, foundation work, and manufacture and assembly of components. However, preliminary activities such as planning, designing, financing, permitting, surveying, testing, and similar activities do not qualify. The "safe harbor" test will find a project has begun construction if it has expended five (5) percent or more of the total cost of the project and the proponent makes "continuous efforts" to complete the project.

California law provides two mechanisms that could expedite procurement and construction of renewable energy projects by avoiding traditional competitive bidding requirements:

- Government Code sections 4210.10 through 4210.19 authorize local agencies to execute sole source or informally procured "energy service contracts" to construct and operate renewable energy and energy efficiency projects based on contractor experience, technology, costs, and other considerations, or to a vendor within a "pool" created per Public Utilities Code section 388 (described below). The agency must find at a public meeting that the cost of the project will be less than the anticipated marginal cost of energy that would have been consumed if the project was not constructed, and that funding for operating the project will come from the project's projected

revenues. If a facility ground lease applies, the agency must also find that any difference between the fair rental value of the property and the agreed rent is offset by below-market energy purchases or other benefits provided under the energy service contract.

- Public Utilities Code section 388 allows local agencies to enter into contracts with qualified energy service companies for a term not exceeding 35 years for various energy efficiency projects. It allows local agencies to establish "pools" of qualified vendors who are awarded individual energy savings or energy retrofit contracts through a competitive process. A vendor's inclusion in the pool must be based on qualifications, experience, pricing, or other relevant factors, and the pool must be reestablished every two years or it will automatically expire.

We recommend that agencies interested in qualifying for elective pay tax credit payments to finance their renewable energy projects "begin construction" as soon as possible to guarantee their continued eligibility for the payments after the Act's deadlines expire. If your agency would like assistance in expediting the procurement and construction of eligible renewable projects to take advantage of these tax credit payments, please contact Leah Castella, Joan Cox, or Davin Widgerow.

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[1] An accelerated deadline applies to projects receiving material assistance from "prohibited foreign entities" affiliated with China, North Korea, Russia, or Iran—these projects must begin construction by **December 31, 2025**.