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Practice Update

Start of Construction For Solar and Wind Projects in a Post-OBBBA World

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On August 15, 2025, the Treasury Department and the Internal Revenue Service (IRS) released Notice 2025-42 (the Notice) eliminating the safe harbor under which solar and wind projects could establish start of construction by paying or incurring five percent of the total costs of the facility (the **5% Safe Harbor**), with an exception for small projects (not greater than 1.5 megawatts). The changes made by the One Big Beautiful Bill Act (**OBBBA**) leave only a short window for solar and wind projects to be eligible for clean electricity tax credits under Sections 45Y and 48E, requiring either that they start construction by July 4, 2026, or are placed in service by December 31, 2027.

The Notice marks a change to long-standing guidance (the **BOC Notices**)[1] that permitted projects to start construction either by meeting the 5% Safe Harbor or by conducting physical work of a significant nature (the **Physical Work Test**). Notably, the Notice only applies to wind and solar facilities that begin construction after September 1, 2025. The Notice does not apply to any other type of technology that is eligible for Section 45Y or Section 48E tax credits or the legacy energy tax credits under Sections 45 and 48 (for which construction had to start before January 1 of this year).

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Prior to the OBBBA, the technology-neutral tax credits under Sections 45Y and 48E were expected to be available for qualifying projects that started construction through at least 2036 and probably into the 2040s, based on projected greenhouse gas emissions levels. For technologies other than wind and solar, the OBBBA shortened the runway to start of construction to the end of 2035, with reduced credit rates for projects that start construction during 2034 and 2035.

The OBBBA also added a complicated set of rules that eliminate the Section 45Y and Section 48E credits for projects funded by entities or constructed with components from certain prohibited foreign entities, which include North Korea, China, Russia, and Iran (the **FEOC Rules**). The FEOC Rules that limit the percentage of components from certain foreign entities that can be included in a facility (referred to as "material assistance") apply to projects that start construction after 2025. Section 7701(a)(51)(J) provides that for purposes of the definition of a "prohibited foreign entity," beginning of construction is determined under rules similar to the those in Notices 2013-29 and 2018-59 (as well as any subsequent guidance clarifying, modifying, or updating either Notice, as in effect on January 1, 2025). The Notice would appear to follow this directive in that it includes a footnote stating that the Notice does not apply for purposes of determining the applicability of the FEOC Rules. Thus, a wind or solar project has until the end of this year to start construction by incurring costs before the material assistance preclusions take effect; whereas such projects (other than those eligible for the low output exception) only have until September 1 of this year to use the 5% Safe Harbor method to avoid the 2027 placed in service deadline.

Start of Construction under the BOC Notices

As mentioned above, there are two ways to start construction under the BOC Notices — that is the Physical Work Test and the 5% Safe Harbor.

The Physical Work Test considers whether "physical work of a significant nature" started at the site or at a factory that is making equipment for the project.[2] There is no fixed minimum amount of work or monetary percentage threshold required under the Physical Work Test. Physical work of a significant nature includes both work performed by the taxpayer and work performed for the taxpayer by third parties pursuant to a binding contract. Examples of onsite work include installation of racks or other structures to affix photovoltaic panels, collectors or solar cells, pouring foundations, and building maintenance roads. Offsite work can include manufacturing custom components, such as transformers, switchgear, and other custom power conditioning equipment. Actual physical work must occur. Further, physical work to manufacture components cannot be for components held or normally held in inventory by a vendor.

The other way to start construction is to satisfy the 5% Safe Harbor, which requires paying or incurring at least five percent of the total project cost.[3] For a cash method taxpayer, payment generally occurs when payment is made. For an accrual method taxpayer, costs for goods or services are not normally incurred merely by spending money. There generally must also be either delivery or transfer of title. However, there is an exception that permits costs to be incurred at the time of payment if the goods or services are "reasonably expected" to be provided within 105 days after payment.

Under either method, there is a "continuity" requirement that must be met from the time construction starts through completion of the project — that is, a "continuous program of construction" under the Physical Work Test and "continuous efforts" towards completion under the Safe Harbor (either requirement, the ***Continuity Requirement***). The Continuity Requirement will be deemed satisfied if the project is placed in service by the end of the fourth calendar year after the calendar year

during which start of construction occurred (the ***Continuity Safe Harbor***).

Following the enactment of Section 45Y and Section 48E, the Treasury Department and the IRS issued Notice 2022-61 to provide, among other things, guidance for determining when construction begins for purposes of these credits. Section 5 of Notice 2022-61 states that principles similar to those under Notice 2013-29 regarding the Physical Work Test and 5% Safe Harbor apply, and taxpayers satisfying either test will be considered to have begun construction. Section 5 of Notice 2022-61 also provides that principles similar to those in the BOC Notices regarding the Continuity Requirement and the Continuity Safe Harbor apply for purposes of the clean electricity credits.

Notice 2025-42

Notice 2025-42 was issued pursuant to an Executive Order signed by President Donald Trump that directed the Secretary of the Treasury Department, within 45 days following enactment of the OBBBA, to take any necessary and appropriate actions to strictly enforce the termination provisions in the OBBBA with respect to solar and wind facilities. The Notice states that the Treasury Department and the IRS have determined that eliminating the 5% Safe Harbor for solar and wind projects "is necessary and appropriate" to further the directive in the order — that is, to prevent taxpayers from "circumventing" the termination dates under the OBBBA, prevent the "artificial manipulation of eligibility" for the credits, and ensure that a "substantial portion" of the facility is built by the start of construction deadline.

The Executive Order also issue other guidance on implementing the FEOC restrictions added by the OBBBA.

The changes made by the Notice do not affect the ability of developers to start construction by meeting the Physical Work Test. While the standards

governing the Physical Work Test are set forth in Notice 2025-42, the substance is generally consistent with what is required to establish satisfaction of the Physical Work Test under the existing BOC Notices (as described above).

Again, it is important to note that Notice 2025-42 has limited application. It does not replace the existing BOC Notices or eliminate use of the 5% Safe Harbor generally. In most instances, both the 5% Safe Harbor and Physical Work Test remain unchanged and available at the taxpayer's option. Notice 2025-42 only affects solar and wind projects with nameplate capacities greater than 1.5 megawatts that start construction after September 1, 2025, and seek to avoid the placed in service deadline added by the OBBBA. The exception for smaller facilities applies based on the aggregate net output of multiple facilities with "integrated operations." For this purpose, a solar facility is treated as having integrated operations with one or more other solar facilities of the same technology type if the facilities are: (i) owned by the same or related taxpayers, (ii) placed in service in the same taxable year, and (iii) transmit electricity through the same interconnection point (or, for behind-the-meter facilities and facilities that are not grid-connected, are able to support the same end user).

Implications

Notice 2025-42 has critical implications for developers, leaving them with just a few weeks to start construction by incurring costs in order to use the 5% Safe Harbor. The 5% Safe Harbor enables developers with available capital to stockpile components for future projects by entering into master purchase agreements for solar components such as modules, racking and inverters, and assigning the components to specific projects down the road. This approach was used by many developers in 2019 in order to start construction before a rate phase down for the legacy credits under Sections 45 and 48. At that time, accrual method taxpayers often used the special rule

described above and made payment as late as December 31, 2019, for goods that were not reasonably expected to be delivered until early 2020 (within the 105-day period following payment) and, in so doing, were treated as starting construction in 2019 under the 5% Safe Harbor.

The practical impact of the change is arguably only a matter of shortening the time frame to start construction of a solar project under the 5% Safe Harbor by a few months, as the FEOC rules could prove unworkable for solar projects given the limited domestic supply chain for solar components and that projects need to start construction by the end of this year to avoid the FEOC material assistance restrictions. However, for projects that can meet the FEOC hurdle, the Notice does significantly shorten the runway to start construction by incurring costs, as the OBBBA changes terminating the credits for wind and solar projects placed in service after 2027 do not apply to projects that start construction by July 4, 2026 (almost 11 months from now), and such projects could be placed in service as late as 2030 and still qualify for credits under Sections 45Y and 48E.

Questions remain about whether the Notice will withstand challenge if stakeholders decide to take legal action. There is certainly an argument that eliminating a method for starting construction that has been used without question and consistently included in start of construction guidance for more than a decade circumvents congressional intent. This argument is bolstered by the fact that the Safe Harbor remains available to all technologies except solar and wind, which is relevant for the four-year Continuity Safe Harbor and will be relevant in 2032 to avoid the rate phase-downs. The 5% Safe Harbor also remains available for all technologies (including solar and wind) through the end of this year for purposes of the FEOC material assistance restrictions. Moreover, Section 7701(a)(51)(J) effectively codifies the 5% Safe Harbor as a means of

starting construction for purposes of the FEOC Rules.

Citations

[1] *See* Notice 2013-29, 2013-20 I.R.B. 1085; *clarified by* Notice 2013-60, 2013-44 I.R.B. 431; *clarified and modified by* Notice 2014-46, 2014-36 I.R.B. 520; *updated by* Notice 2015-25, 2015-13 I.R.B. 814; *clarified and modified by* Notice 2016-31, 2016-23 I.R.B. 1025; *updated, clarified, and modified by* Notice 2017-04, 2017-4 I.R.B. 541; Notice 2018-59, 2018-28 I.R.B. 196; *modified by* Notice 2019-43, 2019-31 I.R.B. 487; *modified by* Notice 2020-41, 2020-25 I.R.B. 954*; clarified and modified by* Notice 2021-5, 2021-3 I.R.B. 479; *clarified and modified by* Notice 2021-41, 2021-29 I.R.B. 17; Notice 2020-12, 2020-11 I.R.B. 495.

[2] *See Notice 2013-29* at § 4.01.

[3] *Id.* at § 5.01.
