

Treasury Issues Stricter Beginning of Construction Rules for Wind and Solar Projects

August 18, 2025

Introduction

Notice 2025-42, issued on August 15, 2025, provides guidance on establishing the beginning of construction for purposes of claiming clean energy tax credits for wind and solar facilities under section 45Y and section 48E of the Internal Revenue Code. Under the notice, taxpayers must satisfy a physical work test and, except for low-output solar projects, can no longer rely on spending at least 5% of the total cost of a facility to demonstrate the beginning of construction.

Background

The budget reconciliation act known as the “One Big Beautiful Bill Act” (“OBBBA”), signed on July 4, 2025, eliminated clean energy tax credits for solar and wind projects under section 45Y and section 48E unless they either begin construction by July 7, 2026 or are placed in service by December 31, 2027. In a July 7, 2025 executive order, the president instructed the Treasury Department and the Internal Revenue Service (“IRS”) to issue guidance within 45 days of OBBBA’s enactment that strictly defines “beginning of construction” to enforce the early termination of the section 45Y and section 48E credits for wind and solar projects. The notice was issued in response to the president’s executive order.

Establishing Beginning of Construction Under the Notice

Prior to the notice, taxpayers relied on IRS guidance allowing the choice between a “5% safe harbor” and “physical work test” to establish the beginning of construction when claiming clean energy-related tax credits. Under the 5% safe harbor, a taxpayer could demonstrate the beginning of construction by showing that the taxpayer had incurred at least 5% of the total cost of the facility and thereafter made continuous efforts towards advancing completion (or placed the project in service no more than 4 years of beginning construction). The notice restricts the use of the 5% safe harbor to low-output solar facilities.

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For all other wind and solar projects, taxpayers must meet the physical work test to establish beginning of construction. The physical work test is a facts and circumstances analysis that requires the taxpayer to begin “physical work of a significant nature,” either directly or under a binding written contract entered into prior to the beginning of construction, and to maintain a continuous program of construction. Work may be performed on or off-site. Examples of on-site physical work of a significant nature for a wind facility include excavating a foundation for a turbine, setting turbine anchor bolts into the ground, or pouring concrete pads of a foundation. For a solar project, on-site physical work of a significant nature includes installing racks and other structures to affix solar panels to a site. Offsite work can include manufacturing components, mounting equipment, support structures such as racks and rails, inverters and transformers, and other power conditioning equipment. Preliminary activities such as planning or designing the project, researching, exploring, conducting environmental studies, obtaining permits and licenses, clearing a site and excavating to contour land do not qualify as physical work of a significant nature. Physical work of a significant nature also does not include work performed to produce a component of a wind or solar facility that is in existing inventory or normally held in inventory by a supplier.

To establish the beginning of construction, the notice also requires taxpayers to maintain a continuous program of construction until a project is placed in service. Taxpayers may rely on a continuity safe harbor, which treats construction as continuous if a project is placed in service no more than 4 calendar years after the calendar year in which construction began. If a taxpayer does not meet the safe harbor, it may meet the continuity requirement by satisfying a facts and circumstances test, which considers whether the taxpayer continues physical work of a significant nature. Certain excusable disruptions are not be treated as stopping physical work: delays due to severe weather or natural disasters, delays in obtaining permits, interconnection delays, supply shortages, labor stoppages, financing delays, and similar issues.

The notice also includes rules to determine when to treat multiple facilities that are operated as part of a single project as one facility, application principles for retrofitted facilities, and rules with respect to transfers of facilities after they have begun construction.

The rules of the notice apply to wind and solar projects that begin construction on or after September 2, 2025.

Practical Implications of the Notice

Retracting the 5% safe harbor is likely to significantly reduce the number of wind projects that will be eligible for clean energy credits under section 45Y or section 48E because it will be harder for developers to prove the beginning of construction using only the physical work test. Developers have historically preferred to rely on the 5% safe harbor rather than the physical work test for several reasons. It is easier to demonstrate that a taxpayer has incurred 5% of the total cost of a project by a particular date than it is to meet the subjective facts and circumstances analysis of when physical work of a significant nature begins. Another disadvantage of the physical work test is that physical work of a significant nature typically can begin only later in a project’s lifecycle, after many other hurdles have been met, such as environmental studies, obtaining permits and licenses, and grading and other site preparation. As a result, we expect that many projects that would have otherwise qualified under the 5% safe harbor will not meet the physical work standard of the notice.

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