

Parsing Clarifications On Foreign Entity Rules For Tax Credits

By **Maureen Linch, Jason Factor and Reina Kim** (March 4, 2026)

Last month, the Internal Revenue Service and the U.S. Department of the Treasury issued provisional guidance on the supply chain components of the prohibited foreign entity rules enacted in July 2025 as part of the law known as the One Big Beautiful Bill Act.

Released Feb. 12, IRS Notice 2026-15 describes forthcoming proposed regulations to help taxpayers claiming renewable energy tax credits determine whether these taxpayers have received material assistance from prohibited foreign entities, or PFEs. These entities are taxpayers with contractual, governance, equity-related or debt-related ties to covered nations.

The notice answers several supply chain questions the industry has raised. It also provides safe harbors that taxpayers can use until final regulations are issued.

But a number of key questions remain, particularly about the impact of entering into contracts with, or issuing debt to, companies with ties to the covered nations of China, North Korea, Russia or Iran.

Background

The PFE rules prevent prohibited foreign entities and taxpayers that receive material assistance from these entities from accessing most renewable energy tax credits.

To claim credits, taxpayers must ensure the cost of the components and materials used in taxpayers' projects or products stay below certain limits. This is based on a formula called the material assistance cost ratio, or MACR. The MACR compares the total costs of a project or product to the costs attributable to materials that were mined, produced or manufactured by PFEs.

The Notice

The notice addresses some questions — both answered and unanswered — that the industry has asked about calculating the MACR, and includes safe harbors that taxpayers can use until regulations are issued.

Answered Questions

Whose Tax Year Matters

The notice identifies which tax year matters for purposes of determining which costs are attributable to a PFE — the purchaser's or the supplier's. For a direct sale, it is based on the tax year of the direct supplier rather than the customer.

For a resale, it is based on the tax year of the entity that mined, produced or manufactured



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the product or component.

Which Tax Year Matters

The statute provides the determination of whether an entity is a PFE is made as of the last day of the year, but the statute does not explain which tax year matters — the year the materials are purchased or the year the credits are claimed. The notice clarifies that the relevant year is the one in which the taxpayer claiming a credit incurs the costs under its method of accounting.

For example, if X Co, an accrual method taxpayer with a calendar year, incurs costs in 2026 for materials it incorporates into Section 45X eligible components that it sells in 2027, the costs of the materials would be PFE costs if the supplier of the materials is a PFE as of Dec. 31, 2026.

Entities Without U.S. Taxable Years

If a foreign supplier does not have a U.S. tax year, its PFE status is based on the calendar year.

Direct Material Costs

The notice gives a number of details about determining direct material costs. In general, it provides that taxpayers should follow the existing guidance under Sections 461 and 263A to determine direct material costs, including Treasury Regulations, Section 1.471-3.

It confirms that freight-in and tariffs paid or incurred by the taxpayer generally are treated as direct material costs. And it allows taxpayers to apply an averaging convention for constituent materials of the same type — averaged over an elected "specified period of time" — to determine the material costs for a particular product or project.

Rules are provided for direct material costs incurred in a Section 45X contract manufacturing arrangement.

Resellers

If a direct supplier is merely a reseller, the PFE test is applied to the entity that mined, produced or manufactured the material. For example, if X Co buys materials from Y Co that merely resells the materials it buys from Z Co, the producer of the materials, then X Co must determine whether the materials are PFE-sourced based on the PFE status of Z Co, not Y Co. The notice does not provide a definition of the term reseller, but it is possible that the definition of the term under IRS guidance in the context of Section 263A could apply.

Interim Safe Harbors

The notice includes several interim safe harbors taxpayers may rely on in calculating the MACR until proposed regulations are issued. Taxpayers may choose between actual cost tracking or using one or more of three safe harbors depending on the particular situation.

Unanswered Questions

Definition of PFE

The notice does not provide any color on the definitions of "specified foreign entity" and "foreign-influenced entity," the two main categories of PFEs. For example, the notice does not address the many questions U.S. public companies are asking about whether they can issue debt in worldwide public offerings without inadvertently becoming foreign-influenced entities.

Effective Control Test

A taxpayer that makes a payment to a specified foreign entity under an IP licensing agreement entered into or modified on or after July 4, 2025 is treated as a foreign-influenced entity by virtue of granting the specified foreign entity "effective control." Guidance on the effective control test is very limited. The notice provides only one example in which a taxpayer becomes a foreign influenced entity by making a payment under a contract that grants effective control to a specified foreign entity.

Final Thoughts

Taxpayers involved in the supply chain for renewable energy tax credits, such as companies that mine critical minerals, produce components or manufacture credit-eligible products likely will see Notice 2026-15 as providing welcome interim guidance in untangling the intricate web of new PFE rules.

The safe harbors, the averaging convention, and the certainty with respect to which and whose tax year matters in determining MACR will be particularly helpful. But taxpayers that are not directly involved in the renewable energy industry will need to continue to wait for useful guidance from the IRS to determine the implications of their debt-related and contractual ties with specified foreign entities.

The Treasury and IRS are accepting public comments until March 30.

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