

## Solar ITC Safe Harbors After the “Big Beautiful Bill”: What Developers Need to Know

The One Big Beautiful Bill Act (OBBBA) significantly reshaped the landscape for solar and other renewable energy incentives. In response to a directive from President Donald Trump, the U.S. Department of the Treasury and the Internal Revenue Service (IRS) on August 15, 2025, issued Notice 2025-42, which provides important guidance on what it means to “begin construction” for purposes of the solar investment tax credit (ITC).

The changes emanating from the OBBBA tighten the ITC eligibility rules and accelerate the timeline for projects that wish to claim the ITC. The principal safe harbors and related protections available to solar developers and investors to maintain eligibility for the ITC are summarized below.

### The “Begin Construction” Exception to the 2027 In-Service Deadline

Under the OBBBA, solar projects must generally be placed in service by December 31, 2027, in order to qualify for the ITC.

There is, however, an *important exception* – if a project can demonstrate that it began construction on or before July 4, 2026, the project remains eligible even if it becomes operational after 2027. This statutory safe harbor is likely considered the *single most important threshold for solar developers* planning beyond 2027.

### The Continuity Safe Harbor

Beginning construction by July 4, 2026, is not enough on its own – a project developer must also show that work continues consistently *until completion*.

To simplify this requirement, the IRS provides what it refers to as a “Continuity Safe Harbor”:

- If a project is placed in service *within four calendar years* of the year in which construction began, continuity is automatically satisfied.
- For example, if construction begins in 2025, the project is deemed continuous if placed in service by **December 31, 2029**.

Projects that miss this four-year window may still qualify, but only if they can prove “continuous construction” based on the facts and circumstances – a higher standard than if the four-year window were satisfied.

## The 5% Safe Harbor – Now Narrowly Limited

For years, developers could “begin construction” by simply incurring at least 5% of total project costs. The OBBBA and the new IRS guidance largely eliminates this path for most solar projects.

Two important exceptions remain:

- Grandfathered projects – if a solar project had already qualified under the 5% method before September 2, 2025, that status remains valid.
- Small projects – solar facilities of 1.5 MW (AC) or less may still use the 5% safe harbor, as long as construction begins no later than July 5, 2026.

For larger, new projects, the 5% safe harbor is no longer available. Developers must rely on the “Physical Work Test” which evaluates the amount and type of actual physical construction completed on and off the project site.

### Excusable Delays

In a recent guidance document, the IRS recognized that certain unforeseen events may cause construction delays that are beyond a developer’s control. The Notice confirms that the following circumstances will not be counted against continuity:

- Severe weather events
- Delays in permitting or interconnection
- Shortages of specialized components
- Labor stoppages
- Financing difficulties tied to supply disruptions or endangered species issues

The foregoing items appear to be intended to protect projects from disqualification when delays are truly unavoidable and beyond the control or influence of a project developer. It is anticipated that these circumstantial exceptions will be narrowly construed and that it will be difficult for developers to demonstrate that the exceptions should be applied to extend completion deadlines.

### Single-Project Treatment

The IRS guidance allows multiple facilities to be treated as a *single project* when they operate together – for example, contiguous arrays under a single power purchase agreement and interconnection. This treatment can help extend timelines, because the “placed in service” date and continuity analysis are made based on the last facility completed.

### Contracting Rules That Support the Physical Work Test

Because the determination of substantial completion for most projects will be based on the application of the *Physical Work Test*, the rules for contracts matter more than ever:

- A binding written contract for off-site construction (such as custom racking or transformers) can qualify as physical work, provided the work is not drawn from existing inventory.

- Master contracts may be assigned to affiliates or project companies, and work performed under them can carry over.
- Contracts limited to preliminary services (e.g., permitting, design, site clearing) or generic equipment from inventory *will not* establish begin-construction status.

These rules give developers flexibility, but they require careful planning, agreement drafting and documentation preparation.

### **Putting It All Together**

To preserve eligibility for the solar ITC based upon the Substantial Construction requirement, the recent IRS guidance imposes the following requirements:

- Start real construction (or qualifying off-site work under contract) by July 4, 2026.
- Document continuity and aim to be in service within four years of the start year.
- Use the 5% Safe Harbor only if grandfathered or the project is less than 1.5 MW (AC).
- Rely on excusable delay protections if unforeseen events push the project beyond the four-year mark.
- Structure contracts carefully to ensure they support the Physical Work Test. (On-site (e.g., racking, foundations) or off-site under binding contract; inventory work does not count.)

### **Key Takeaway regarding Substantial Construction**

The OBBBA and the IRS's recent guidance accelerates the phase-out of solar ITC eligibility and demand more substantive proof of construction progress. Developers and investors should treat the July 4, 2026, deadline as critical, plan for substantial construction activities, and ensure contracts and documentation are aligned with the new requirements and that other requirements for ITC eligibility are satisfied.

### **In Addition to New Substantial Completion Restrictions, Developers Must Satisfy Other New Requirements Such as the Foreign Entity Requirements**

In addition to satisfying the Substantial Construction requirements, developers must satisfy new requirements established by the OBBBA that affect eligibility for the solar ITC, such as the *foreign entity rules* and requirements.

### **Foreign Entity Rules for the Solar ITC – Key Highlights**

Expansion of “Foreign Entity of Concern” (FEOC) Rules to Solar ITC are as follows:

- The OBBBA broadens FEOC restrictions originally limited to clean vehicle (30D) credits, extending them to major clean energy tax credits – including Section 48E (clean electricity ITC).
- Entities considered FEOCs are now classified as Prohibited Foreign Entities (PFEs), which include two categories:
  - ■ Specified Foreign Entities (SFEs) – covering entities with disqualifying relations, such as:
    - Chinese military-connected companies
    - Entities restricted under the Uyghur Forced Labor Prevention Act

- Battery-manufacturing firms barred from U.S. Department of Defense contracts (e.g., CATL, BYD, Gotion, Envision, etc.)
- Foreign-controlled entities by China, Russia, North Korea, or Iran with majority ownership or control.
- Foreign-Influenced Entities (FIEs) – entities under influence of an SFE via any of the following:
  - Appointment of senior officers (e.g. CEO, CFO, board positions)
  - Greater than 25% ownership
  - Greater than 40% aggregate ownership by SFEs
  - Greater than 15% of total debt held by Chinese lenders at issuance
  - Payments or contracts that give “effective control” to an SFE over facility operations, component production, or licensing agreements.

### Restrictions on Claiming the Solar ITC (Section 48E)

- A taxpayer cannot claim the Solar ITC (Section 48E) if:
  - The taxpayer is itself a Prohibited Foreign Entity (PFEs) (either an SFE or FIE).
  - The project sources critical components or “material assistance” from a PFE beyond allowable thresholds.
  - The project involves licensing critical technology from a PFE.
  - The project involves significant financial arrangements (payments, loans, royalties) with a PFE.

The foreign entity rules apply starting with the tax year beginning after enactment—for calendar-year taxpayers, that’s 2026. Foreign-Influenced Entity (FIE) restrictions depend on the specific credit and for Section 48E, the FIE restriction applies immediately in the tax year following enactment, i.e., starting 2026 for most projects.

### Key Takeaway Regarding Foreign Entity Restrictions

Under the OBBBA, significant new foreign entity restrictions now apply to the solar ITC. Projects and taxpayers must ensure they are not themselves controlled by or influenced by PFEs – which include entities with ties to certain foreign countries or banned companies. Additionally, the sourcing, licensing, and payments associated with the project must be carefully structured to avoid disqualification.

We will continue to monitor developments related to the issues discussed in this Alert and will provide updates accordingly. Please contact the author with questions concerning the solar ITC or to discuss your specific business circumstances.

### Related Attorneys

