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## IRS Releases Notice 2025-42 Addressing Start of Construction for Purposes of Energy Credit Phase Outs Under OBBBA

On August 15th, the IRS released IRS Notice 2025-42 (“the Notice”), providing guidance, consistent with Executive Order 14315 (July 7, 2025) titled Ending Market Distorting Subsidies for Unreliable, Foreign-Controlled Entity Sources, 90 F.R. 30821 (the “Executive Order”), regarding when construction of an applicable wind facility or an applicable solar facility described in Section 2.02 of the Notice has begun for purposes of determining whether such facility is subject to the credit termination provisions added to Code Sections 45Y and 48E pursuant to the One Big Beautiful Bill Act (“OBBBA”).

OBBBA, signed into law on July 4, 2025, provides for a phase out of the clean electricity production tax credit available pursuant to Code Section 45Y and the clean electricity investment tax credit available under Code Section 48E for solar and wind projects that fail to place in service on or before December 31, 2027, unless construction of such projects begins within one year of the date of enactment of OBBBA (i.e., no later than July 4, 2026) (the “Phase Out Rules”).

The Executive Order directed the Secretary of Treasury to take necessary and appropriate action to strictly enforce the Phase Out Rules. Such actions were to include issuing new and revised guidance to ensure that policies concerning the “beginning of construction” are not circumvented and prevent the “artificial acceleration or manipulation of eligibility.” The Executive Order included specific directions to “restrict[] the use of broad safe harbors” unless a substantial portion of the solar or wind facility has been built.

As outlined in prior IRS notices , under previous guidance a taxpayer may establish that an applicable wind facility began construction either by incurring 5% or more of the eligible costs to construct qualified property, or by undertaking physical work of a significant nature.<sup>1</sup> Conversely, under the Notice, only the physical work test (as described in Section 3.02 of the Notice) may be used to determine whether a solar or wind facility has begun construction for purposes of the Phase Out Rules. However, Section 6 of the Notice provides a limited exception allowing certain “low output solar facilities” having a maximum net output of no more than 1.5 megawatts (AC) (the “1.5 MW Exception”), to utilize either the physical work test described in Section 3.02 of the Notice or the 5% safe harbor (as described in Section 5 of Notice 2013-29).

<sup>1</sup> See, IRS Notice 2013-29 (2013-20 IRB 1085), IRS Notice 2013-60 (2013-44 IRB 431), IRS Notice 2014-46 (2014-36 IRB 520), IRS Notice 2015-25 (2015-13 IRB 814), IRS Notice 2016-31 (2016-23 IRB 1025), IRS Notice 2017-4 (2017-4 IRB 541), IRS Notice 2018-59 (2018-28 IRB), IRS Notice 2019-43 (2019-31 IRB 487), IRS Notice 2020-414 (2020-25 IRB 954), IRS Notice 2021-41 (2021-29 IRB 17), and IRS Notice 2022-61 (2022-52 IRB 560).

Consistent with other Treasury Regulations under Code Section 45Y and 48E, for purposes of the 1.5 MW Exception, the IRS will scrutinize whether co-located solar facilities should be considered an integrated single solar facility. Such scrutiny will examine whether one or more other solar facilities of the same technology type are:<sup>2</sup>

- (i) owned by the same or related taxpayers;
- (ii) placed in service in the same taxable year; and
- (iii) transmit electricity generated by the facilities through the same point of interconnection, or, if the facilities are not grid-connected, are delivering electricity directly to an end user behind a utility meter, or are able to support the same end user.

If, based on the above factors, the solar facilities are determined to be a single, integrated facility with a net output larger than 1.5 megawatts (AC), then such facilities will be ineligible for the 1.5MW Exception.

Overall, much of the guidance provided in the Notice with respect to satisfying the physical work test is largely consistent with prior IRS notices, including:

- Physical work of a significant nature includes both on-site and off-site work, and may include work performed by the taxpayer or another person under a binding written contract.<sup>3</sup>
- Off-site work on a facility may include the manufacture of components, mounting equipment, support structures such as racks and rails, inverters and transformers (used in electrical generation to step up the voltage to less than 69 kilovolts) and other power conditioning equipment.<sup>4</sup>
- The Notice generally retains the same non-exclusive list of preliminary activities undertaken on a facility that do not qualify as physical work of a significant nature.<sup>5</sup>
- Work to produce components held in inventory does not qualify.
- The Notice requires taxpayers to maintain a continuous program of construction, unless in the case of excusable delays. A taxpayer is still deemed to satisfy the continuity requirement if the facility is placed in service within 4 years from the date construction began.<sup>6</sup>
- The Notice retains the rules for establishing when physical work begins under a binding written contract or under a master contract.<sup>7</sup>
- The Notice retains factors established under prior Notices for determining when multiple facilities will be treated as a single project for purposes of the Notice and retains the rule that the determination of whether multiple facilities are operated as part of a single project is made in the calendar year in which the last of the facilities is placed in service.<sup>8</sup>
- Retention of the “80/20 rule” for retrofitted properties.<sup>9</sup>
- Same rules for transferring safe harbored projects.<sup>10</sup>

The Notice includes a non-exclusive list of examples to illustrate what may constitute on-site physical work for solar and wind facilities.<sup>11</sup> For wind facilities, on-site physical work of a significant nature begins with the beginning of the excavation of the foundation, the setting of anchor bolts into the ground, or the pouring of concrete pads of the foundation. Consistent with prior guidance, to the extent that the

<sup>2</sup> See IRS Notice 2025-42, Section 6.03(3).

<sup>3</sup> See *id.*, Sections 3.02 and 3.03.

<sup>4</sup> See *id.*, Sections 3.03(1) and (2).

<sup>5</sup> See *id.*, Section 3.04.

<sup>6</sup> See *id.*, Section 4.

<sup>7</sup> See *id.*, Section 5.01(1).

<sup>8</sup> See, IRS Notice 2025-42, Sections 5.02(2) and (3).

<sup>9</sup> See *id.*, Section 5.04.

<sup>10</sup> See *id.*, Section 5.05.

<sup>11</sup> See *id.*, Section 3.03(2).

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wind turbines and tower units are assembled on-site from components manufactured off-site by a third-party manufacturer, physical work of a significant nature begins at the manufacturer's facility when manufacture commences, but only if the work is performed pursuant to a binding written contract (as described below), and such components are not held in the manufacturer's inventory. A manufacturer that produces components for multiple facilities must use a reasonable method used to associate individual components with a particular facility.

For solar facilities, on-site physical work of a significant nature may include the installation of racks or other structures to affix PV panels, collectors, or solar cells to a site.

Section 3.05 of the Notice provides that physical work does not include work to produce a component or part that is held in inventory "by one selling the component/part to the taxpayer." Prior guidance included a similar rule, generally excluding physical work done to produce such components or parts "by a vendor." This nuanced change in language from "by a vendor" to "by one selling the component/part to the taxpayer" suggests that the IRS will apply this rule by reference to the business practices of the specific vendor or supplier, rather than by reference to what is customary, generally, in the industry.

Like the existing rules, the Notice requires the taxpayer to maintain a continuous program of construction with respect to the solar or wind facility, except for excusable delays.<sup>12</sup> The Notice retains the safe harbor under the prior guidance, which deems the continuity requirement to be met so long as the facility is placed in service no more than 4 calendar years after the start of construction.

The Notice is effective for applicable wind and solar facilities which did not begin construction (as determined under Section 5 of Notice 2022-61) prior to September 2, 2025. However, the Notice only applies for purposes of determining whether construction began on or before July 4, 2026, for purposes of the Phase Out Rules. As noted in footnote 3 to the Notice, the guidance set forth in the Notice is not intended to address the start of construction for purposes of the "foreign entity of concern" restrictions, which will be addressed in subsequent guidance released by the IRS. Presumably, prior guidance addressing the start of construction in relation to other provisions contained in Code Sections 45Y and 48E will remain in effect.

<sup>12</sup> See id., Sections 4.01 and 4.02.

