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Shifting Ground: How IRS Notice 2025-42 Redefines When Construction Begins for Applicable Wind and Solar Facilities

On August 15, 2025, the Internal Revenue Service (IRS) released Notice 2025-42, consistent with President Trump's recent Executive Order 14315 (EO 14315), which changes how applicable wind and solar facilities establish the beginning of construction (BOC) for purposes of the clean-energy tax credit termination provisions added to Sections 45Y and 48E of the Internal Revenue Code (IRC) by the One Big Beautiful Bill Act (OBBBA). You can read more about EO 14315 in our prior blog post, available here. IRS Notice 2025-42 represents a clear shift away from a predominantly cost-based BOC metric toward an approach grounded in demonstrable physical construction, and it has immediate practical and contractual consequences for project sponsors, tax-equity investors, lenders and their counsel. Notice 2025-42 only applies to clean energy properties under IRC Sections 45Y and 48E that utilize wind or solar technology.

Importance of Determining the BOC Date

The OBBBA amended IRC Sections 45Y and 48E to require that wind and solar projects that are not placed in service by December 31, 2027, must begin construction prior to July 5, 2026, in order to be eligible for tax credits under those provisions, respectively. Accordingly, the determination of a project's BOC date can be critical to whether the project qualifies for tax credits. IRS Notice 2025-42 was a direct response to the president's directive in EO 14315 that the Treasury Department issue guidance to prevent the potential manipulation of BOC rules.

Physical Work Test as the New Default Metric for Establishing the Beginning of Construction

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The single most consequential change is the elimination of the widely used 5% cost safe harbor for wind projects and solar facilities with a maximum net output greater than 1.5 MW (AC). For those projects, taxpayers generally must now rely on the "Physical Work Test" to establish BOC. A narrow "low-output" solar exception preserves the 5% safe harbor for solar facilities that are 1.5 MW AC or smaller, but that exception is tightly constrained by aggregation rules designed to prevent artificial fragmentation (e.g., rules that look to common ownership, timing of placed-in-service, and shared interconnection or common behind-the-meter beneficiaries). These changes take effect for projects that begin construction on or after September 2, 2025 (IRS Notice 2025-42's prospective application) and should be treated as a new default for most utility-scale wind and solar projects.

Under the Physical Work Test, construction begins when "physical work of a significant nature" commences; the determination remains a facts-and-circumstances inquiry focused on the nature of the work rather than on a particular dollar threshold. Practically speaking, satisfying the Physical Work Test typically means mobilizing crews and performing site work such as foundation excavation, setting anchor bolts, pouring concrete pads (wind), or installing racking and structures (solar). Limited off-site manufacturing of custom components can qualify, but only if manufacturing starts under a binding written contract executed before production begins and the items are not normally kept in the manufacturer's inventory. IRS Notice 2025-42 continues to exclude routine preliminary activities—design, permitting, environmental studies, financing, and general site clearing that does not rise to "significant" physical work—even if those costs are capitalized.

This change of direction from a financial test to an operational test meaningfully transfers a material portion of project risk from finance and legal teams to construction and operations teams. Under the 5% safe harbor, a wired payment or executed purchase order could lock in a BOC date; however, under IRS Notice 2025-42, documentary evidence of real, on-the-ground work is paramount. The upshot is that developers must plan for less-predictable variables, such as permitting delays, weather, interconnection

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timelines, equipment lead times and labor availability, to be front-and-center in determining tax credit eligibility. Tax-equity investors and lenders are likely to demand more robust, contemporaneous proof of physical work (e.g., date-stamped photos and video with metadata, signed construction logs, independent engineering confirmations, and binding manufacturing contracts showing bespoke production start dates).

Evidence of Continuing Construction Required if Facility Not Placed in Service Before Expiration of Continuity Safe Harbor Provision

IRS Notice 2025-42 also tightens the continuity standard for projects that extend beyond the four-calendar-year placed-in-service safe harbor. The familiar four-year safe harbor remains unchanged, but if a facility is not placed in service within that four-year window, the IRS will now require evidence of a continuing program of physical construction (not merely "continuous efforts" such as permitting, contracting, or financing) to satisfy continuity under the facts-and-circumstances test. While IRS Notice 2025-42 lists certain non-exclusive "excusable disruptions" (e.g., severe weather, permitting delays, interconnection delays, delays in manufacturing custom components, labor stoppages, financing delays and supply shortages), any claim that a pause was excusable will require meticulous contemporaneous documentation tying the disruption to the lapse in physical construction.

Deferred Guidance and Enhanced Restrictions Applicable to Foreign Entities of Concern

A separate and critical source of uncertainty is IRS Notice 2025-42's explicit deferral of guidance on the BOC standard that will apply for the OBBBA's "foreign entity of concern" (FEOC) sourcing and ownership restrictions. Footnote 3 of IRS Notice 2025-42 makes clear that the Treasury Department and IRS intend to issue additional FEOC-specific BOC guidance, and the statute itself ties FEOC compliance to an earlier deadline (projects beginning construction after December 31, 2025, can trigger FEOC

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restrictions). Because the statutory text for FEOC references prior beginning-of-construction notices (which historically included the 5% safe harbor), IRS Notice 2025-42 leaves developers with a genuine two-track compliance dilemma: (1) either rely on the 5% safe harbor to meet the FEOC timing risk and potentially face disagreement with subsequent guidance, or (2) accelerate physical work to satisfy the Physical Work Test before the earlier FEOC deadline and incur operational and financing costs sooner. In practice, risk-averse developers and investors are likely to plan conservatively to meet the strictest plausible standard by the earlier deadline, which will compress construction, permitting and manufacturing schedules across the market and could create bottlenecks.

Potential Legal Challenges to IRS Notice 2025-42

These regulatory changes invite potential administrative and legal challenges. Possible arguments include Administrative Procedure Act claims that differential treatment of wind and solar (relative to other technologies) is arbitrary without a more robust administrative record, and statutory-construction challenges that the Treasury Department's selective departure from prior BOC frameworks, which Congress referenced in the OBBBA for particular rules, may exceed the agency's permissible interpretation steps. The success of any challenge will depend on the administrative record the Treasury Department compiles and the factual basis it provides for the distinctions it draws.

Key Takeaways for Project Sponsors, Tax-Equity Investors, and Lenders

IRS Notice 2025-42 is a decisive policy shift that converts BOC from a largely contractual/financial milestone into an operational, evidence-driven milestone for most wind and solar projects. That shift alters who controls BOC risk inside a project (moving it toward operations and construction), increases diligence burdens for tax equity and lenders, and amplifies the strategic value of early, verifiable physical work. Market participants should document aggressively, rework schedules and procurement to create

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qualifying physical milestones earlier, and engage with the Treasury/IRS during the pending rulemaking on FEOC to seek clarity and workable standards.

Under this revised framework, developers should assume that the Physical Work Test will be the default route to preserve eligibility for the wind and large-scale solar tax credits and should immediately strengthen operational documentation and contracting practices. Key practical steps include executing and retaining binding manufacturing contracts (with clear non-inventory language); maintaining contemporaneous construction logs and date-stamped photos/videos; obtaining independent engineering attestations of "significant" work; and negotiating financing documents with updated representations, covenants and allocation of BOC risk (including indemnities, milestone escrows or credit backstops where appropriate). For FEOCs, conservative planning should aim to satisfy the Physical Work Test on or before December 31, 2025, to neutralize FEOC timing risk, while continuing to monitor and engage on forthcoming FEOC guidance.

At Frost Brown Todd, we pride ourselves on understanding each client's project objectives through each phase of its lifecycle, with an eye toward the evolving regulatory landscape. To assess your project's eligibility and risk exposure under IRS Notice 2025-42, or to prepare documentation strategies, please contact the authors or any attorney with Frost Brown Todd's Renewable Energy and Tax Planning teams.

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