

# Now & Next

Renewable Energy Tax Credit Alert

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## **Court restores Five Percent Safe Harbor before July 4, 2026, deadline**

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With July 4, 2026, deadline approaching, court vacates IRS Notice 2025-42; The Five Percent Safe Harbor method remains available for Wind and Solar - for now.



## What's the impact?

- The US District Court for the District of Columbia held that IRS Notice 2025-42, which eliminated the Five Percent Safe Harbor, was arbitrary and capricious under the Administrative Procedure Act (APA) and vacated it in full.
- The Five Percent Safe Harbor is restored for all wind projects and for solar projects with a maximum net output above 1.5 megawatts (measured in alternating current). The Physical Work Test was not affected by the Notice and remains available for all projects.
- The court remanded the matter to the IRS for further consideration, meaning the IRS could issue a revised notice that again eliminates the Five Percent Safe Harbor with adequate APA justification, potentially on a compressed timeline, given the proximity of the deadline.
- The window to satisfy the Five Percent Safe Harbor has reopened for now, but clients should be cautious not to treat the court decision as confirmation that the Safe Harbor will remain available beyond the July 4, 2026, deadline.

The US District Court for the District of Columbia has vacated IRS Notice 2025-42, which (among other things) eliminated the Five Percent Safe Harbor for all wind projects and for solar projects with a maximum net output above 1.5 megawatts, leaving the Physical Work Test as the sole available method for those projects to establish beginning construction before the July 4, 2026 deadline under Code Sections 45Y and 48E.

# Background

## THE JULY 4, 2026, DEADLINE

The One Big Beautiful Bill Act (OBBBA), enacted July 4, 2025, amended the technology-neutral clean electricity production tax credit (Code Section 45Y) and clean electricity investment tax credit (Code Section 48E) to cut off eligibility for **wind and solar** facilities that do not begin construction on or before **July 4, 2026**. Projects that miss that date can only qualify if placed in service by December 31, 2027.

Since 2013, the IRS has recognized two methods by which a taxpayer can establish beginning of construction.

- / **Physical Work Test:** The taxpayer begins “physical work of a significant nature” before the deadline and maintains continuous progress through completion (IRS Notice 2013-29, Section 4.01).
- / **Five Percent Safe Harbor:** The taxpayer pays or incurs at least five percent of the total cost of the facility before the deadline and maintains continuous progress through completion (IRS Notice 2013-29, Section 5.01).

These two methods have been consistently reaffirmed in a dozen IRS notices spanning from 2013 through 2022, and Congress has repeatedly enacted and extended credit regimes with beginning-of-construction eligibility conditions without directing any changes to these established standards. Notice 2022-61 extended these rules to credits determined under Sections 45Y and 48E.

## Executive Order 14315 and Notice 2025-42

Shortly after enactment of the OBBBA, President Trump issued Executive Order 14315, “Ending Market Distorting Subsidies for Unreliable, Foreign-Controlled Energy Sources,” directing the Treasury Department to take all action necessary to “strictly enforce the termination” of the Code Sections 45Y and 48E credits for wind and solar, including by “restricting the use of broad safe harbors unless a substantial portion of a subject facility has been built.” In response, the IRS issued **Notice 2025-42**, which eliminated the Five Percent Safe Harbor for all wind projects and for solar projects with a maximum net output above 1.5 megawatts that did not begin construction before September 2, 2025. The notice left the Physical Work Test intact and preserved the Five Percent Safe Harbor only for small solar projects; i.e., those with a maximum net output of no more than 1.5 megawatts.

## The court's decision

In *Oregon Environmental Council et al. v. Internal Revenue Service et al.*, Civil Action No. 25-4400 (D.D.C. June 6, 2026), the court granted the plaintiffs' motion for summary judgment and **vacated Notice 2025-42 in full**, remanding it to the agency for further consideration.

The court held that the notice was arbitrary and capricious under the APA for failing to justify a departure from more than a decade of consistent IRS guidance on which developers, investors, and lenders had substantially relied. Among the key points in the court's decision were:

- / The IRS had consistently recognized both the Physical Work Test and the Five Percent Safe Harbor since 2013, and taxpayers throughout the clean energy industry structured transactions relying on those standards.
- / Congress enacted several rounds of changes to tax credits to which the IRS guidance applied, without ever directing the IRS to change its approach.
- / The Notice, which contained a single paragraph of reasoning for eliminating the Five Percent Safe Harbor, failed to offer sufficient justification for departing from more than a decade of consistent IRS guidance on which the industry had substantially relied.

It is important to note that the District Court's ruling does not alter the July 4, 2026, deadline for beginning construction or the OBBBA's prohibited foreign entity restrictions.

## An important caveat: This holding may be short-lived

In a marketplace that relies on predictable rules, this decision may not provide comfort to developers or investors. Indeed, the court acknowledged that "under the circumstances, a significant amount of uncertainty and disruption are inevitable."

Given the proximity of the July 4, 2026, deadline, most developers were already scrambling to satisfy the Physical Work Test, which was never affected by Notice 2025-42 and remains fully available regardless of the court's ruling. For those projects, the restoration of the Five Percent Safe Harbor provides little additional relief. Moreover, if the IRS issues a revised notice on remand, it will be primarily focused on correcting the procedural deficiencies identified by the court—namely, providing more robust APA-compliant justification for restricting the Safe Harbor, rather than reaching a different substantive result.

Developers should therefore plan on the basis that the Physical Work Test remains the more reliable path to establishing beginning of construction before the July 4, 2026, deadline, and should not assume the Five Percent Safe Harbor will survive a revised IRS notice.

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