From Safe Harbors to Physical Work: Understanding the New Treasury Guidance

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With the passage of the One Big Beautiful Bill (OBBB), Congress sought to rein in abuses of the energy tax credits created under the Inflation Reduction Act (IRA). In particular, the Investment Tax Credit (ITC) and the Production Tax Credit (PTC) now face earlier phase-out dates and stricter construction requirements.

Under the IRA and Obama-era guidance, developers were able to exploit flexible construction standards that allowed them to "begin" projects with minimal effort or investment, locking in lucrative tax credits long before real work occurred. These loopholes fueled speculation, inflated project valuations, and raised concerns that taxpayer dollars were subsidizing paperwork rather than power generation.

In coordination with Congress' efforts to end these tax credits and their persistent abuses, President Donald Trump issued an Executive Order "Ending Market Distorting Subsidies for Unreliable, Foreign Controlled Energy Sources" on July 7, 2025. This Executive Order required the Treasury and Interior Departments to issue new guidance within 45 days to enforce the termination of tax credits under the One Big Beautiful Bill and eliminate loopholes and carveouts for the ITC and PTC.

Guidance Gives Guardrails

When Congress passes a law, executive agencies often issue guidance documents detailing how that law will be implemented and applied. Guidance documents determine the practical application of the law and set the documentation requirements and deadlines that ultimately decide who qualifies to receive benefits. The U.S. Department of the Treasury is responsible for issuing and enforcing the rules that govern tax credits for energy projects.

Old Energy Tax Credit Guidance Loopholes

To qualify for a tax credit, developers must demonstrate that it is a valid energy project by meeting a construction requirement. Under the old guidance associated with the IRA, construction requirements could be satisfied by either a physical work test or a safe harbor investment provision.

The old physical work test required "physical work of a significant nature," which includes both on-site work and off-site work. Developers could "start construction" by performing off-site activities, such as manufacturing parts, without beginning any actual on-site construction. Contract start dates for custom projects served as a "beginning of construction date" for projects and allowed off-site work to count as physical work of a significant nature.

Even when work was done on-site, developers could perform limited work, such as digging a few foundation holes, constructing temporary roads, or pouring a concrete pad, and argue that this counted as "significant". Since there was no dollar amount or percentage of project completion requirement tied to the physical work test, developers were often granted the benefit of the doubt in determining whether the requirement was met.

The safe harbor provision required companies to invest a minimum of 5 percent of the project's estimated total cost to qualify for the ITC or PTC. Under the old guidance, this allowed companies to count expenditures such as ordering parts for wind or solar systems, or contracting out their design toward the 5 percent investment minimum without needing to install the components ordered on-site.

New Guidance Closes Doors, but Leaves Room for Runarounds

The new guidance released by the Treasury closes some of these loopholes. However, the new guidance leaves room for some runarounds, allowing subsidies for certain green energy projects.

The most significant change in the new guidance is the elimination of the safe harbor provision, effective September 2, 2025. Ending this provision is a step in the right direction, as it forces developers to demonstrate real physical progress in order to qualify for a tax credit, rather than merely writing checks.

However, the guidance also includes a carveout for "low-output" solar projects of 1.5 megawatts or less. These solar projects would continue to qualify for the 5 percent investment safe harbor. The carveout was designed with residential solar arrays in mind; however, most residential solar systems in the United States are between six and eight kilowatts. Producing one megawatt of electricity requires roughly 10 acres of land dedicated to solar arrays. As a result, this carveout allows solar farms to continue accessing the tax credit under the old safe harbor provisions rather than limiting it to homeowners installing smaller-scale systems.

For solar projects above 1.5 megawatts, developers must now use the physical work test to establish that construction begins by July 4, 2026. This requires showing "work of a significant nature" and meeting a continuity requirement.

Yet the definition of "significant" remains vague. The new guidance does not establish minimum hours, dollar amounts, or percentage of total project costs specified for either on-site or off-site work to satisfy this requirement. As the new guidance states, "This test focuses on the nature of the work performed, not the amount or the cost." This leaves the determination of whether a project qualifies to the judgment of the Treasury official reviewing the credit claim, rather than providing strict criteria that must be met. Both on-site and off-site work continue to count toward the physical work test.

Other loopholes also remain. One is the treatment of transformers. Transformers are used to adjust the voltage of the electricity produced to a level suitable for the grid. While transformers are integral to electricity production, they are not always installed on site. Often, they are installed at local and central substations. The new rules allow off-site work at qualified facilities, including transformer production and installation, to count as "significant" physical work. This means developers can claim to have met the physical work test by manufacturing transformers or installing them at substations, rather than by building on the actual project site itself.

Similarly, the custom contract carveout survives. A developer can still order custom equipment to be designed and produced, such as turbine blades, inverters, and solar panels, and use the date work pertaining to the contract began as the construction start date. Even if developers do not perform work on-site, as long as work specified in the contract begins, then developers are able to claim the credit.

The guidance also continues the policy allowing developers to bundle multiple facilities together as a single project for credit purposes. Developers with multiple facilities can bundle those facilities into one project for the purpose of meeting the beginning of construction deadline. Factors used to determine whether facilities should be classified as a single project include whether they are located on contiguous pieces of land, share a common power purchase agreement, rely on a shared substation, or operate under a master construction contract. The one positive feature of this rule is that it ensures several small systems totaling more than 1.5 megawatts, if integrated, are treated as a single large project and must meet the construction requirement rather than exploiting the safe harbor exemption.

Room for Improvement, Reasons for Optimism

An additional opportunity still remains for guidance to further the policy goals of the OBBB. The Treasury has not provided directions on how the foreign entities of concern provisions in the OBBB will apply to developers. This guidance is expected to come later and could include provisions which will mandate developers prove their lack of ties or cut ties immediately to entities such as China. This provision could eliminate many of the projects by effectively removing a major supplier of wind and solar components as well as the rare earths those systems rely on.

The new guidance takes an important step toward tightening the rules for ITC and PTC eligibility, but its impact will ultimately depend on how rigorously Treasury enforces the definition of "significant" for the physical work test and how they address the role of foreign entities of concern. Without strong and consistent administration, developers may still exploit loopholes, weakening the policy goals Congress and the Administration intended to advance.