Articles + Publications | June 12, 2026

District Court Vacates IRS Notice 2025-42, Restoring Five Percent Safe Harbor Option for Beginning of Construction

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KEY POINTS

- A federal district court vacated IRS Notice 2025-42 as arbitrary and capricious under the APA, restoring the five percent safe harbor for wind and large solar projects claiming Section 45Y or 48E credits.
- The vacatur was granted nationwide, with the matter remanded to Treasury and the IRS for further consideration.
- The court held that the Notice represented a major policy shift implicating serious reliance interests, unsupported by reasoned explanation in the administrative record.
- Despite the ruling, the risk of reversal on appeal and the approaching July 4, 2026, beginning of construction deadline may limit developers' willingness to rely on the restored five percent safe harbor.

On June 6, 2026, the U.S. District Court for the District of Columbia vacated Notice 2025-42 (the Notice) in *Oregon Environmental Council v. IRS*, No. CV-25-4400. The Notice had eliminated the long-standing Five Percent Safe Harbor for establishing the beginning of construction date for wind and large solar projects, leaving most facilities to qualify only under the Physical Work Test, despite years of Internal Revenue Service (IRS) guidance and industry investment based on the dual-test framework.

A coalition of environmental, consumer, tribal, and public-sector plaintiffs challenged the Notice, arguing that it would raise power prices, disrupt clean energy development, and increase pollution. The court held that the Notice was arbitrary and capricious under the Administrative Procedure Act (APA).

The court vacated the Notice nationwide and remanded it to the U.S. Department of the Treasury (Treasury) and the IRS, effectively restoring the Five Percent Safe Harbor while leaving the door open to further rulemaking or appeals.

BACKGROUND

For more than a decade, the IRS used two methods to determine when an energy project had "begun construction" for credit-qualification purposes: the long-standing Physical Work Test (requiring "physical work of a significant nature") and the Five Percent Safe Harbor (incurring at least 5% of total project costs). That framework was repeatedly reaffirmed in guidance from 2013 onward and was extended to the technology-neutral energy

credits under Sections 45Y and 48E.

The One Big Beautiful Bill Act accelerated the phase-down of Sections 45Y and 48E specifically for wind and solar by imposing earlier deadlines (beginning construction by July 4, 2026, or, for later-started projects, placing in service by December 31, 2027). Shortly thereafter, Executive Order 14315 directed Treasury to "strictly enforce" the termination of the credits for wind and solar projects, and to issue revised guidance ensuring that beginning-of-construction rules could not be "circumvented," including by limiting broad safe harbors unless a "substantial portion" of a facility was built by the July 4 deadline.

On August 20, 2025, Treasury and the IRS issued the Notice, providing that for all wind projects and most solar projects, the beginning of construction for purposes of Sections 45Y and 48E would be determined exclusively under the Physical Work Test, while the Five Percent Safe Harbor would remain available only for relatively small solar facilities (those with a maximum net output of 1.5 megawatts or less).

- Troutman Pepper Locke Insight: In practical terms, this meant that wind and most solar projects placed in service after 2027 could qualify only if "physical work of a significant nature" began by July 4, 2026.

THE COURT'S ANALYSIS

Following an extensive analysis of threshold procedural issues, the court addressed whether the Notice was arbitrary and capricious under the APA. It emphasized that, for more than a decade, the IRS had consistently applied the dual test framework (Physical Work Test and Five Percent Safe Harbor), which the court separately noted Congress had expressly adopted in subsequent legislation. In departing from the prior framework, the Notice offered a brief, high-level rationale, asserting that the change was necessary to enforce the statutory termination dates, prevent circumvention and "artificial" manipulation of eligibility, and ensure that a substantial portion of qualifying wind and solar facilities would be built by the deadline. The court found the Notice to be a major policy shift that implicated serious reliance interests and lacked a reasoned explanation: Treasury and the IRS did not adequately justify eliminating the Five Percent Safe Harbor for wind and most solar while retaining it for small solar, did not meaningfully engage with extensive comments highlighting reliance interests and technology-neutrality concerns, and did not explain why targeted anti-abuse tools would be insufficient. The administrative record, in the court's view, failed to connect generalized concerns about "circumvention" to the specific decision to single out wind and large solar for stricter treatment in a technology-neutral regime.

Finally, in weighing the appropriate remedy, the court applied the standard APA factors and concluded that vacatur of the Notice was warranted. It characterized the legal defects as serious — going to the heart of the agencies' reasoning process rather than a minor procedural misstep — and observed that leaving the Notice in place during a remand would perpetuate the very harms and uncertainty the plaintiffs described. While acknowledging that vacatur could cause some disruption, the court found that uncertainty would persist in any event given the impending statutory deadlines and the likelihood of further agency action or appellate review. It therefore set the Notice aside nationwide and remanded the matter to Treasury and the IRS for further consideration.

- Troutman Pepper Locke Insight: Despite the court's decision to set aside the Notice, concerns remain that the decision will be reversed on appeal. Such concerns, along with the short time remaining before the July 4 deadline, will limit the probability that developers will choose to utilize the Five Percent Safe Harbor following the

decision.

Please contact any of the authors of this advisory if you have further questions or need help implementing beginning of construction strategies.

Gibson Odderstahl also contributed to this article. He is not licensed to practice law in any jurisdiction; bar admission pending.

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