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**MEMORANDUM**

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RE: Legal and Regulatory Risks Arising from Executive Order on "Beginning of Construction" Rules for Clean Energy Tax Credits

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## I. INTRODUCTION

On July 7, 2025, President Trump issued an Executive Order (EO) directing the Department of the Treasury to take action within 45 days to "strictly enforce the termination" of the clean electricity production and investment tax credits under I.R.C. §§ 45Y and 48E, with a particular focus on ensuring that these credits are not claimed through manipulation or premature invocation of the "beginning of construction" rules.

Among other things, the EO directs the Secretary of the Treasury to issue:

> "new and revised guidance…to ensure that policies concerning the 'beginning of construction' are not circumvented, including by preventing the artificial acceleration or manipulation of eligibility and by restricting the use of broad safe harbors unless a substantial portion of a subject facility has been built."

Although the Executive Order formally targets Sections 45Y and 48E (renewables), any changes to the underlying safe harbor rules—particularly those altering or narrowing the 5% safe harbor—would have significant and immediate implications for other credit regimes that rely on the same framework, including Section 45Q (carbon capture) and Section 45V (clean hydrogen).

## II. CURRENT GUIDANCE ON BEGINNING OF CONSTRUCTION

### A. Legal Framework

The IRS has recognized two core methods for determining when a taxpayer has begun construction on a qualifying energy facility:

1. Physical Work Test
    - Satisfied when "physical work of a significant nature" begins, either on-site (e.g., grading, foundation) or off-site (e.g., fabrication of project-specific components).
    - Evaluated under a facts and circumstances standard.

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2. Five Percent Safe Harbor
    - Satisfied when a taxpayer incurs at least 5% of total project costs.
    - First introduced in IRS Notice 2013-29, and reaffirmed in a number of additional notices addressing multiple extensions and different tax credits.
    - Designed to provide a bright-line rule for developers and investors, facilitating financial close (FID) and tax equity structuring.

Both methods require the taxpayer to satisfy a continuity requirement, often presumed satisfied if the facility is placed in service within a defined period (typically 4–10 years depending on the credit).

### B. Section 45Q Guidance

For carbon capture projects, the IRS issued specific guidance in:

- Notice 2020-12 – Adopts both the Physical Work Test and the Five Percent Safe Harbor.
- Revenue Procedure 2020-12 – Provides a safe harbor for partnership allocations, but does not address construction timing.
- The Continuity Safe Harbor was initially six years, but was extended to 10 years in some contexts to accommodate project complexity and permitting delays.

### C. Section 45V: Current Status

As of July 2025, there is no standalone guidance specific to Section 45V regarding the "beginning of construction."

However:

- Treasury and industry have operated under the reasonable expectation that 45V would follow precedent established under 45Q and other energy credits.
- Many hydrogen project sponsors have already incurred costs or executed contracts in reliance on the existing 5% safe harbor framework.
- The One Big Beautiful Bill Act moved up the termination of the Section 45V credit to projects the construction of which begins before January 1, 2028 (from January 1, 2033), which accelerates the need for beginning of construction guidance.

## III. LEGAL RISKS FROM EXECUTIVE ORDER

### A. Potential Regulatory Changes

The EO directs Treasury to "prevent the artificial acceleration or manipulation of eligibility" "restrict the use of broad safe harbors unless a substantial portion of a subject facility has been built." There has been much speculation of how Treasury will implement this directive, but some possibilities include:

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- Modifying or eliminating the Five Percent Safe Harbor;
- Requiring more substantial construction before eligibility is established;
- Applying changes retroactively or quasi-retroactively to projects already in development.

Such moves could undermine project financing. In addition, there is also a lot of uncertainty regarding how any such changes could impact projects other than solar and wind projects, particularly for capital-intensive hydrogen and CCS projects that must secure offtake, permitting, and financing before initiating large-scale construction.

### B. Standard of Review in Litigation

Any regulatory change would be subject to judicial review under the Administrative Procedure Act (APA):

- Under 5 U.S.C. § 706(2)(A), courts may set aside agency action found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."
- Agencies must acknowledge and explain departures from prior policy and account for reliance interests. See *FCC v. Fox Television Stations*, 556 U.S. 502 (2009).
- Following *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024), Chevron deference has been eliminated, meaning courts now must review agency interpretations de novo.
- Any attempt to retroactively revoke or substantially revise the 5% safe harbor without transition relief may be vulnerable to APA challenge or to challenge under I.R.C. § 7805(b).
- Any attempt to issue guidance without providing an opportunity for notice and comment may be vulnerable to APA challenge.

A materially different or retroactive application of "beginning of construction" criteria could be vulnerable if Treasury fails to:

- Justify the departure from long-standing precedent;
- Interpret similar statutory language similarly;
- Provide transition relief or grandfathering;
- Consider taxpayer reliance and investment-backed expectations.

One way Treasury may attempt to thread the needle on these issues is to adopt an anti-avoidance rule of sorts for solar and wind projects, for example, to prevent developers from meeting the begin construction standard by simply contracting for equipment without actually starting any physical work.

## IV. RECOMMENDATIONS

1. Maintain Legal Certainty for Projects in Development Through a Bright-Line Safe Harbor

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Treasury should maintain a clearly defined safe harbor (e.g., 5% test) applicable to Sections 45Q and 45V. Any new or revised guidance should not affect projects already under development or those that have reasonably relied on existing IRS guidance. Such actions to decrease eligibility would increase legal uncertainty and undermine established reliance interests, particularly for hydrogen and CCS projects with long lead times and multi-year procurement cycles.

If changes to the beginning of construction guidance are under consideration, they should not penalize projects currently under development, include clear transition rules allowing projects under development to rely on present guidance, and avoid introducing vague "substantial construction" thresholds that lack legal clarity.

**2.** Issue Prompt, Dedicated Guidance for Section 45V

Given the absence of current guidance, Treasury should issue guidance aligning 45V with established practice under 45Q. This guidance should confirm that both the Physical Work and 5% Cost tests are available, define a reasonable continuity safe harbor (e.g., 10 years), and avoid introducing ambiguity or retroactive criteria.

**3.** Prepare for Legal Challenge if Final Rules Are Overbroad or Retroactive

Stakeholders should prepare to:

- Develop an administrative record of reliance for affected projects;
- Submit public comments opposing any unjustified narrowing of existing safe harbors;
- Pursue litigation under the APA if final rules are arguably arbitrary or in violation of statutory authority.

## V. CONCLUSION

President Trump's Executive Order presents a clear policy shift intended to restrict the use of clean energy tax credits by narrowing eligibility tests. While Treasury retains rulemaking discretion, it must act consistently with administrative law and statutory authority. Stakeholders should closely monitor Treasury's forthcoming actions and prepare for both comment and litigation phases to defend taxpayer rights and project viability.