NELSON MULLINS

CONFIDENTIAL MEMORANDUM

To: Fortified Solar LLC

From: Martin Gitlin
Seth L. Proctor

Date: August 29, 2025

Re: **Application of Beginning of Construction Safe Harbors**

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1. Introduction.

The purpose of this Memorandum is to address the tax and timing considerations regarding when construction begins, or is deemed to begin, pursuant to the Internal Revenue Code of 1986, as amended (the "**Code**").[1] Generally, similar rules regarding "beginning construction" apply to both the energy credit and clean electricity investment credit under sections 48 and 48E of the Code (the "**Investment Credits**"), respectively.

The One Big Beautiful Bill Act was enacted on July 4, 2025 (the "**Act**"), and contains significant changes to the current tax credits available following the enactment of the Inflation Reduction Act of 2022. Among these is a repeal of the section 48E credit (the "**48E Credit**") for projects that begin construction more than twelve (12) months following the date on which the Act was enacted or are placed in service after December 31, 2027 (regardless of when construction begins). As such, the date on which a project begins construction, or is deemed to begin construction, would be determinative as to whether taxpayers are eligible for tax credits potentially arising from such a project.

Currently, Fortified Solar LLC, a Delaware limited liability company ("**Fortified**") is in the business of manufacturing, marketing and selling integrated structures incorporating solar panels and solar-panel related products, as well as related services (the "**Business**"). As part of the Business, Fortified enters into agreements with customers to manufacture and cause to be installed certain structures, which include integrated solar photovoltaic power systems (each a "**Manufacturing Contract**").

Pursuant to the Manufacturing Contracts, Fortified will design, build, and supervise the installation of the contracted-for structure at the site selected by the customer. Additionally, each Manufacturing Contract requires the customer to pay Fortified a non-refundable amount equal to at

[1] References in this Memorandum to "Section" or "§," unless otherwise indicated, are references to the Code or Treasury regulations promulgated under the Code.

least five percent (5%) of the total agreed upon price for the manufacture and installation of the structure. If work is conducted pursuant to the terms of the Manufacturing Contract, the customer makes periodic payments based on the progress of the work performed by Fortified and, upon final payment and delivery to the customer, the structure's ownership fully vests with the customer.

2. Beginning Construction Generally.

Similar "beginning construction" rules apply to both section 48 and section 48E projects.[2] Accordingly, principles similar to the "Physical Work Test" and "Five Percent Safe Harbor apply," and those who meet either test will be considered to have begin construction. Additionally, for the clean energy investment credit under section 48E, principles similar to the "Continuity Safe Harbor" apply to both the Physical Work Test and Five Percent Safe Harbor.[3]

These safe harbors permit those who begin construction and make continuous construction efforts to be safe harbored based on the date when the projected began construction, provided the facility is placed in service within four calendar years after the calendar year in which construction began.[4] Though both methods may be used to establish the date on which construction began, construction will be deemed to have begun on the first date either of the two tests is met.[5]

a. The Physical Work Test

The Physical Work Test focuses on the nature of work performed rather than costs, meaning there is neither a fixed minimum amount of work nor financial threshold that must be reached. To meet the test, a taxpayer must establish that physical work of a "significant" nature began on a certain date, with both on- and off-side physical work being considered.[6]

Significant off-site physical work may include manufacturing components, mounting equipment, support structures (*e.g.*, rails and racks), inverters, and other power conditioning equipment.[7] On-site physical work can include acts such as installing components, equipment, or structures.[8] Significant physical work taken into account can also include work performed by a contractor under a binding written contract.[9] However, work to produce components of energy property that either exist in, or are normally held in, the inventory of a vendor is not taken into account.[10]

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[2] *See* Notice 2013-29; Notice 2023-29 (applying prior notices regarding sections 45 and 48 to determine "beginning construction" for the purposes of sections 45Y and 48E).
[3] *See* Notice 2016-31, § 3, Notice 2023-29.
[4] Notice 2022-61, § 5. This disregards the requirement that projects be placed in service on or before December 31, 2027 that is contained in the version of the Act passed by the U.S. House of Representatives on May 22, 2025.
[5] Notice 2018-59, § 3.02.
[6] Notice 2018-59, § 4.01.
[7] Notice 2018-59, § 4.02.
[8] *Id.*
[9] Notice 2018-59, § 7.03.
[10] Notice 2018-59, § 4.05; Notice 2013-29, § 4.02(2).

b. The Five Percent Safe Harbor

Rather than relying on the Physical Work Test, a taxpayer may rely on the Five Percent Safe Harbor. This test safe harbors the beginning of construction date as the date on which a taxpayer can establish it has paid or incurred 5% or more of the total cost of the energy property.[11] Generally, all costs included in a property's depreciable basis are taken into account for the Five Percent Safe Harbor.[12] Similarly, amounts paid or incurred for the construction, manufacture, or production of components of the energy property for the taxpayer pursuant to a binding written contract that is entered into prior to the amounts actually being paid of incurred are taken into account for the Five Percent Safe Harbor.[13]

However, the cost of land or property not integral to the energy property itself is not taken into account.[14] Additionally, should the total cost of a project exceed its anticipated total cost, *i.e.*, 5% of the anticipated cost is less than 5% of the actual cost, the safe harbor will not be satisfied.

c. The Continuity Requirement

Both the Physical Work Test and Five Percent Safe Harbor apply the Continuity Requirement, *i.e.*, a taxpayer must meet one of the tests and then make continuous progress towards completing construction once it is deemed to begin. The Physical Work Test uses the "Continuous Construction Test," and the Five Percent Safe Harbor uses the "Continuous Efforts Test."[15]

The Continuous Construction Test looks to all facts and circumstances to determine whether there has been continuous physical work of a significant nature.[16] Some disruptions in effort are disregarded, however, such as those occurring as a result of a natural disaster or that are due to a shortage of labor or supplies.[17] The Continuous Efforts Test also examines all facts and circumstances to determine whether there have been continuous efforts to advance completion of a project.[18]

Facts indicating continuous efforts being made to complete a project include (but are not limited to):

(i) paying or incurring additional amounts included in the total energy property cost;
(ii) entering into binding written contracts to manufacture, construct or produce components of property, or for future work to construct the energy property;
(iii) obtaining required permits; and

[11] Notice 2018-59, § 5.01.
[12] Notice 2018-59, § 5.02.
[13] Notice 2018-59, § 7.03.
[14] *See generally,* Notice 2018-59 and Notice 2022-61.
[15] Notice 2018-59, §§ 6.01 and 6.02.
[16] *Id.*
[17] Notice 2018-59, § 6.05.
[18] *Id.*

(iv) performing significant physical work.[19]

3. Transfers Prior to Placed-in-Service Date.

Generally, there is no statutory requirement that the taxpayer placing a facility in service be the same taxpayer that began construction of such a facility.[20] As such, "fully or partially developed energy property may be transferred without losing its qualification under the Physical Work Test or Five Percent Safe Harbor" for Investment Credits purposes.[21] Similarly, construction may begin on energy property with the intent to develop the energy property at a certain site, but then be transferred to a different site where development is completed.[22] In such a situation, the work performed or amounts incurred prior to such a site transfer can be taken into account for determining if the property satisfies either the Physical Work Test or Five Percent Safe Harbor.[23]

However, if there is a transfer of solely tangible personal property (including contractual rights to the property under a binding written agreement) to an unrelated party, "any work or amounts paid or incurred by the transferor with respect to [the property] will not be [considered] with respect to the transferee for the purposes of the physical Work Test or the Five Percent Safe Harbor.[24] For these purposes, parties are "related" if the transferor and transferee are (i) in the case of an individual, an individual who is related by blood or marriage, (ii) an entity with 20% common ownership, or (iii) another member of a controlled group of corporations.[25]

For example, assume (i) Taxpayer 1 pays or incurs $60,000 to have tangible personal property integral to Project 1 manufactured off-site under a binding written agreement in 2018, (ii) incurs no further costs or development activity regarding Project, and (iii) sells the tangible personal property to Taxpayer 2, who is unrelated to Taxpayer 1, in 2019 for use in Project 2. In such a situation, the $60,000 paid or incurred by Taxpayer 1 would be disregarded for the purposes of determining if Taxpayer 2 met the Five Percent Safe Harbor in 2018 because Taxpayer 1 and Taxpayer 2 are unrelated.[26]

Accordingly, if a customer of Fortified where to enter into a binding written agreement with Fortified to produce and purchase energy property for which one of the Investment Credits is allowed, such a customer could transfer the contracted-for property to a related party without affecting the application of either the Physical Work Test or Five Percent Safe Harbor. However, if a customer were to transfer the contracted-for property to a person who is unrelated, amounts previously paid or incurred, or work performed, under the parties' agreement would not be taken

[19] Notice 2018-59, § 6.
[20] Notice 2013-60, §5, *clarified and modified by* Notice 2014-46, §4.
[21] *See* Notice 2018-59, §8.01.
[22] Notice 2018-59, §8.02.
[23] *Id*.
[24] Notice 2018-59, §8.03(1).
[25] *Id*.
[26] Notice 2018-59, §8.03(2).

into account for the purpose of determining when the transferee is considered to have begun construction.

4. Post-One Big Beautiful Bill Act Guidance – Notice 2025-42

On August 20, 2025, the U.S. Internal Revenue Service (the "**IRS**") issued Notice 2025-42, which provided updated guidance in line with an Executive Order that instructed the IRS to issue new and updated guidance regarding the "beginning of construction" rules.[27] Beginning on September 5, 2025, most projects are no longer able to rely on the Five Percent Safe Harbor and must instead satisfy the Physical Work Test.[28] However, "low output solar facilities" may continue to use the Five Percent Safe Harbor.[29]

A "low output solar facility" is any solar facility with a "maximum net output of not greater than 1.5 megawatts (MW) (as measured in alternating current)."[30] For the purpose of determining capacity, the "output is measured at the level of the qualified facility."[31]

5. Application to Fortified Solar Agreements.

The entering into, and making payments the up-front payment pursuant to, the Manufacturing Agreements will result in the customers of Fortified meeting either of the Physical Work Test or Five Percent Safe Harbor, assuming the Continuity Requirement is met with respect to work performed and the up-front payment is equal to at least five percent (5%) of the final total cost of the solar structure(s) purchased.

First, customers are required to make an up-front payment equal to at least five percent (5%) of the cost of the structure upon entering into a Manufacturing Agreement. Because the Five Percent Safe Harbor requires only five percent (5%) of the total cost of the property to be paid in order to be met, the required initial payment should be more than sufficient to meet the required amount to be paid or incurred in order for construction to be considered to have begun (assuming no unanticipated cost increase results in the initial up-front payment being less than five percent (5%) of the total cost of the structure. Further, even if there is a cost overrun, the fact that the up-front payment is required to be at least this amount minimizes the risk that the amount paid would not equal at least five percent (5%) of the actual cost.

Second, though the actions taken by Fortified largely occur off-site, such off-site work is still considered for the purposes of the Physical Work Test. These efforts should be taken into account and permit customers of Fortified to meet the Physical Work Test because such work would be undertaken pursuant to a binding written agreement, which is taken into account for the purposes of whether construction has begun under the Physical Work Test. However, if some

[27] Exec. Order No. 14315, 90 Fed. Reg. 30821 (July 7, 2025).
[28] Notice 2025-42, § 3.01.
[29] Notice 2025-42, § 6.
[30] Notice 20025-42, § 6.02(1).
[31] *Id*.

initial work includes producing components of the solar energy property incorporated into the structure that are normally held in the inventory of Fortified, then such would be disregarded.

Finally, customers of Fortified should continue to be able to rely on the Five Percent Safe Harbor. As we understand, the systems produced pursuant to the Manufacturing Contracts are expected to have capacities of less than 1.5MW at the facility level. Additionally, even if a customer's system does exceed the 1.5MW maximum, it could still rely on the Five Percent Safe Harbor to determine when construction is deemed to have begun, so long as the Five Percent Save Harbor is satisfied prior to September 5, 2025 (the effective date of Notice 2025-42).

Accordingly, customers of Fortified should be able to rely on either the Physical Work Test or Five Percent Safe Harbor. Because of the structure of payments to be made pursuant to the Manufacturing Agreements, the quantitively focused Five Percent Safe Harbor should be met with respect to Fortified's customers even if the more qualitative requirements Physical Work Test are not met. Further, despite the limitations imposed by Notice 2025-42, customers of Fortified should remain eligible to use the Five Percent Safe Harbor so long as such customers either (i) have projects that will not have a capacity in excess of 1.5MW, or (ii) satisfied the Five Percent Safe Harbor before September 5, 2025.