Energy Tax Alert

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# Treasury and IRS Release Initial FEOC Guidance

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On February 12, 2026, the US Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") released Notice 2026-15 (the "Notice"), which provides initial guidance under the foreign entity of concern ("FEOC") provisions of the One Big Beautiful Bill Act (the "OBBBA").[1]

The Notice focuses on the material assistance limitation (the "Material Assistance Limitation") and provides helpful and workable guidance. Treasury and the IRS expect to include the rules in the Notice in forthcoming proposed regulations. In that respect, the Notice represents an important first step towards providing guidance under the energy provisions of the OBBBA. However, Treasury and the IRS have significant work ahead on a number of critical topics (including the ownership, debt, and effective control FEOC provisions) to provide clean energy industry with the necessary direction to apply the energy provisions of the OBBBA with confidence.

## Background: Material Assistance Limitation under the OBBBA

- The FEOC provisions generally restrict access to energy transition tax credits for taxpayers that are deemed to be owned or otherwise controlled by entities with nexus to China (as well as Iran, North Korea, and Russia). The FEOC provisions include the Material Assistance Limitation.

- Under the Material Assistance Limitation, a qualified facility ("Qualified Facility") will not be eligible for the clean electricity production credit under Section 45Y (the "Tech-Neutral PTC"), and a Qualified Facility or energy storage technology ("EST") will not be eligible for the clean electricity investment credit under Section 48E (the "Tech-Neutral ITC"),[2] in each case, if the facility or project is deemed to include material assistance from a prohibited foreign entity (a "PFE").[3] This limitation generally applies starting in taxable years beginning after July 4, 2025 (i.e., 2026 for calendar year taxpayers), but only for Qualified Facilities or ESTs that begin construction during or after 2026.[4] Projects and facilities eligible for the legacy production tax credit and investment tax credit under Section 45 and Section 48, respectively, are not subject to the Material Assistance Limitation.

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1 We discussed the energy transition provisions of OBBBA here.

2 Except as otherwise noted, all "Section" references are intended to refer to sections of the Internal Revenue Code of 1986, as amended.

3 The term "PFE" means (a) specified foreign entities (including foreign-controlled entities) ("SFEs"), (b) entities under the Effective Control (as defined below) of SFEs and (c) foreign influenced entities ("FIEs"), all as defined under the OBBBA.

4 IRS Notice 2013-29 and IRS Notice 2018-59 provide the relevant "begin construction" standard for this grandfathering rule. The principles of IRS Notice 2025-42 (discussed here) are not relevant for this purpose.

- Similarly, an eligible component ("Eligible Component") will not be eligible for the advanced manufacturing production credit under Section 45X (the "Manufacturing PTC") if the Eligible Component is deemed to include material assistance from a PFE. This limitation generally applies for Eligible Components sold in taxable years beginning after July 4, 2025 (i.e., 2026 for calendar year taxpayers).

- A Qualified Facility, EST, or Eligible Component is considered to include material assistance from a PFE if the material assistance cost ratio (the "MACR") is less than the applicable threshold percentage (the "Threshold Percentage"). The Threshold Percentage varies for Qualified Facilities, ESTs, and for different types of Eligible Components, and increases year by year, thereby making the Material Assistance Limitation more difficult to satisfy over time.[5]

## Deep Dive: Clean Electricity MACR and Eligible Component MACR under the Notice

- The Notice provides rules and procedures for calculating MACR for purposes of applying the Material Assistance Limitation to Qualified Facilities and ESTs ("Clean Electricity MACR") and Eligible Components ("Eligible Component MACR").

- Taxpayers are required to calculate Clean Electricity MACR and Eligible Component MACR for each Qualified Facility and EST placed in service and each Eligible Component sold, respectively, during a taxable year.

- The Notice provides default rules for calculating Clean Electricity MACR based on direct costs ("Direct Costs").[6] Under these rules, project owners are required to:

    - identify the types of manufactured products ("MPs") and manufactured product components ("MPCs") included in the Qualified Facility or EST (or apply the Identification Safe Harbor, discussed below);[7]

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[5] For Qualified Facilities, the Threshold Percentage is 40 percent for a project that begins construction in 2026; 45 percent for a project that begins construction in 2027; 50 percent for a project that begins construction in 2028; 55 percent for a project that begins construction in 2029; and, 60 percent thereafter.

For ESTs, the Threshold Percentage is 55 percent for a project that begins construction in 2026; 60 percent for a project that begins construction in 2027; 65 percent for a project that begins construction in 2028; 70 percent for a project that begins construction in 2029; and, 75 percent thereafter.

For Eligible Components, the Threshold Percentage varies based on the type of component. For instance, for solar components, the Threshold Percentage is 50 percent for components sold in 2026; 60 percent for components sold in 2027; 70 percent for components sold in 2028; 80 percent for components sold in 2029; and, 85 percent for components sold thereafter.

[6] Direct Costs generally include Direct Material Costs and Direct Labor Costs.

- "Direct Material Costs" means the cost of those materials that become an integral part of specific property produced and those materials that are consumed in the ordinary course of production and that can be identified or associated with particular units or groups of units of property produced.
- "Direct Labor Costs" means the costs of labor (full-time and part-time employees, independent contractors, and contract employees) that can be identified or associated with particular units or groups of units of specific property produced, including basic compensation, overtime pay, vacation pay, holiday pay, and certain sick leave pay.

[7] For purposes of the Notice:

- An "MP" is any article, material, or supply that is (a) directly incorporated into a Qualified Facility or EST and (b) produced as the result of a manufacturing process.
- An "MPC" is any article, material, or supply, whether or not the result of a manufacturing process, that is directly incorporated into an MP.
- A "manufacturing process" is a process to alter the form or function of materials or elements of a product in a manner adding value and transforming those materials or elements so that they represent a new item functionally different than would result from mere assembly.

- track the Direct Costs of each MP and MPC and whether the MP or MPC was mined, manufactured, or produced by a PFE ("PFE Produced");
- determine the Direct Costs attributable to each MP or MPC;[8]
- determine the Direct Costs attributable to MPs or MPCs that are PFE Produced ("PFE Direct Costs");[9] and
- calculate the Clean Electricity MACR for the Project as follows:

$$\frac{\text{(Total Direct Costs)} - \text{(Total PFE Direct Costs)}}{\text{Total Direct Costs}}$$

- Similarly, the Notice provides rules and procedures for calculating Eligible Component MACR based on Direct Material Costs.[10] Based on these rules, manufacturers are required to:
  - identify the types of constituent elements, materials, or subcomponents ("Constituent Materials") incorporated into the Eligible Component or consumed in the production of the Eligible Component (or apply the Identification Safe Harbor, discussed below);[11]
  - track the Direct Material Costs of each Constituent Material and whether each Constituent Material was mined, manufactured, or produced by a PFE ("PFE Source");
  - determine the Direct Material Costs attributable to each Constituent Material;[12]

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[8] For purposes of this determination:

- If the project owner produces the MP, Direct Costs include Direct Material Costs and Direct Labor Costs. This will include the cost of any MPCs included in the MP, whether or not produced by the project owner.
- If the project owner acquires the MP, Direct Costs equal the acquisition costs of the MP.
- Costs of integration are excluded: Direct Costs, including Direct Labor Costs, of incorporating MPs into the Qualified Facility or EST are not included as Direct Costs of an MP.

Determination of Direct Costs is not required if the project owner utilizes the Cost Percentage Safe Harbor or the Certification Safe Harbor (described below).

[9] To determine whether an MP or MPC is PFE Produced, a project owner may apply the definition of a "PFE" under the OBBBA or use the Certification Safe Harbor (described below). Whether an MP or MPC is PFE Produced depends on the PFE status of the entity in question as of the taxable year when the project owner paid or incurred the relevant Direct Costs (generally, for accrual method taxpayers, costs are incurred when a project owner produces the MP or MPC or when the project owner is provided the MP or MPC).

For purposes of determining Direct Costs of MPs and MPCs that are PFE Produced:

- If the project owner acquires an MP that is PFE Produced, PFE Direct Costs exclude acquisition costs attributable to MPCs that are not PFE Produced.
- If the project owner acquires an MP that is not PFE Produced, PFE Direct Costs include acquisition costs attributable to MPCs that are PFE Produced.
- If the project owner produces the MP, PFE Direct Costs include acquisition costs of PFE Produced MPCs.

[10] Notably, the calculation of Eligible Component MACR is based on Direct Material Costs rather than Direct Costs. As a result, Direct Labor Costs are disregarded for purposes of this calculation.

[11] Constituent Materials are required to be identified only if their costs are considered Direct Material Costs with respect to the manufacturer's production of the Eligible Component.

[12] A manufacturer is required to determine Direct Material Costs unless the manufacturer relies on the Cost Percentage Safe Harbor or

- determine the Direct Material Costs attributable to Constituent Materials that are PFE Sourced ("PFE Direct Material Costs");[13] and

- calculate the Eligible Component MACR as follows:

$$\frac{\text{(Total Direct Material Costs) – (Total PFE Direct Material Costs)}}{\text{Total Direct Material Costs}}$$

- The Notice provides three interim safe harbors that taxpayers may apply in lieu of accounting for Direct Costs or Direct Material Costs, as the case may be.

  - The "Identification Safe Harbor" permits project owners to identify MPs and MPCs for certain listed project types based on listed components and subcomponents provided in recent IRS guidance for the domestic content bonus (the "Safe Harbor Tables").[14] The listed project types are solar projects (ground-mount and rooftop), onshore and offshore wind projects, battery energy storage facilities, hydropower facilities, and pumped hydropower storage facilities. The Safe Harbor Tables are intended to provide an exclusive and exhaustive list of MPs and MPCs for the listed project types, which should remove any uncertainty from a project owner's compliance with the identification requirement for listed projects. Manufacturers have the benefit of a parallel safe harbor, which provides an exclusive and exhaustive list of materials that constitute Constituent Materials for a narrow list of Eligible Components (solar modules, battery modules using battery cells, and certain types of inverters).

  - Taxpayers that utilize the Identification Safe Harbor may also apply the "Cost Percentage Safe Harbor" in lieu of determining Direct Costs/PFE Direct Costs and Direct Material Costs/PFE Direct Material Costs, as the case may be.

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the Certification Safe Harbor.

For any contract manufacturing arrangement, Direct Material Costs are the direct material costs paid or incurred by the party that performs the actual production activities that bring about a substantial transformation resulting in the Eligible Components. If the party performing the production activities did not incur any or all direct materials costs, then Direct Material Costs also include the direct material costs to the manufacturer claiming the Manufacturing PTC in the contract manufacturing arrangement.

[13] For purposes of this determination:

- Application to direct supplier. For all costs associated with the Constituent Material, manufacturers must apply the definition of "PFE" under the OBBBA to the direct supplier to determine whether a Constituent Material was mined, produced, or manufactured by a PFE.
- Application if direct supplier is a reseller. For all costs associated with the Constituent Material, manufacturers must apply the definition of "PFE" under the OBBBA to the entity that mined, produced, or manufactured the Constituent Material.

Whether a Constituent Material is PFE Sourced depends on the PFE status of the entity in question as of the taxable year during which the manufacturer paid or incurred the relevant Direct Material Costs (generally, for accrual method taxpayers, costs are incurred when a manufacturer produces an Eligible Component or when the manufacturer is provided the Eligible Component).

[14] The term "Safe Harbor Tables" means the tables in Section 5.05 (solar ground-mount), Section 5.06 (solar rooftop), Section 6.02 (onshore wind), and Section 7.02 (battery energy storage) of Notice 2025-08, Section 3.02 of Notice 2024-41 (hydropower and pumped hydropower storage), and Section 3.04 of Notice 2023-38 (offshore wind).

- For purposes of calculating Clean Electricity MACR, the Project owner must (1) track whether the MPs or MPCs listed on the Safe Harbor Tables and incorporated into the listed Qualified Facility or EST are PFE Produced, (2) add up the cost percentages assigned to each MPC and cost percentage assigned to "Production" for the applicable project type on the Safe Harbor Tables ("Total Percentage"), (3) add up the cost percentages assigned to each MPC that is PFE Produced and the cost percentage assigned to "Production" for each MP that is PFE Produced ("Total PFE Percentage"),[15] and (4) calculate Clean Electricity MACR.

- Similarly, for purposes of calculating Eligible Component MACR, the manufacturer must (1) track whether the Constituent Materials listed on the Safe Harbor Tables and incorporated into the listed Eligible Component are PFE Sourced, (2) add up the cost percentages assigned to each Constituent Material included in the listed Eligible Component on the Safe Harbor Tables ("Total Percentage"), (3) add up the cost percentages assigned to each Constituent Material included in the listed Eligible Component that is PFE Produced ("Total PFE Percentage"), and (4) calculate Eligible Component MACR.

- Each of Clean Electricity MACR and Eligible Component MACR is calculated as follows:

$$\frac{\text{(Total Percentage)} - \text{(Total PFE Percentage)}}{\text{Total Percentage}}$$

- Taxpayers may apply the "Certification Safe Harbor," in whole or in part, in lieu of the Cost Percentage Safe Harbor. Consistent with the OBBBA, the Notice confirms that a taxpayer can rely on two types of certifications from direct suppliers: (1) certification that any MP, MPC, Eligible Component, or Constituent Material was not PFE Produced or PFE Sourced or (2) certification as to the amount of total Direct Costs or total Direct Material Costs paid or incurred by the taxpayer of such MP, MPC, Eligible Component, or Constituent Material that was not PFE Produced or PFE Sourced, as applicable. A taxpayer may rely on a certification unless the manufacturer knows (or has reason to know) that the certification is inaccurate.

- Finally, the Notice provides simplifying conventions for the default tracking requirement where the interim safe harbors are not available. In lieu of default tracking:

  - The Notice permits project owners to apply (1) a de minimis assignment-based tracking convention (i.e., tracking by type) for MPs and MPCs representing, in the aggregate, less than 10 percent of the total Direct Costs of a Qualified Facility or EST and (2) for ESTs with capacity under one megawatt (alternating current), an average cost tracking convention for each MP or MPC of the same type incorporated into the same type of EST that were placed in service during the same specified period of time (generally, a chosen time interval falling within a single taxable year).

[15] For purposes of this determination:

- For MPs that are PFE Produced. If some or all of the MPCs included in the MP are not PFE Produced, Total PFE Percentage must include (a) cost percentage assigned to each MPC that is PFE Produced and (b) the cost percentage assigned to "Production."
- For MPs that are not PFE Produced. If some or all of the MPCs included in the MP are PFE Produced, Total PFE Percentage must include the cost percentages assigned to the MPCs that are PFE Produced.

- The Notice permits manufacturers to apply an average cost tracking convention (similar to the convention described in the immediately preceding bullet) for Constituent Materials incorporated in or consumed in production of the same type of Eligible Component produced during a specified period of time (generally, a chosen time interval falling within a single taxable year).

## Other Aspects of the Notice

- Effective Control Guidance. The OBBBA provides that a taxpayer will be barred from claiming the Tech-Neutral PTC, Tech-Neutral ITC, or Manufacturing PTC, if an SFE has effective control over the taxpayer's Qualified Facility or EST, production of Eligible Components, or extraction, processing, or recycling the critical minerals ("Effective Control"). The Notice confirms that if a taxpayer makes a payment to SFE under an intellectual property license related to the foregoing that is entered into (or modified) on or after July 4, 2025 (the enactment date of the OBBBA), the agreement will constitute per se Effective Control.

- Anti-Abuse Rule. The Notice indicates that forthcoming proposed regulations are expected to include anti-abuse rules to prevent entities from evading, circumventing, or abusing the application of restrictions with respect to PFEs, including rules to prevent such evasion, circumvention, or abuse through transfers or alterations of rights, property, or both, including transfers or alterations resulting in lapses of restricted foreign ownership or control that are temporary in nature.

- Reliance on the Notice. Taxpayers may rely on the Notice:

  - to calculate Clean Electricity MACR for any Qualified Facility or EST that begins construction after December 31, 2025 and on or before the date that is sixty (60) days after the publication of the forthcoming proposed regulations in the Federal Register;

  - to calculate Eligible Component MACR for Eligible Components that are sold in taxable years beginning after July 4, 2025 (i.e., 2026 for calendar year taxpayers) and on or before the date that is sixty (60) days after the publication of the forthcoming proposed regulations in the Federal Register;

  - to apply the interim safe harbors for purposes of the Tech-Neutral PTC and Tech-Neutral ITC for any Qualified Facility or EST that begins construction after December 31, 2025 and on or before the date that is sixty (60) days after the publication of the forthcoming safe harbor tables and other guidance under the Material Assistance Limitation; and

  - to apply the interim safe harbors for purposes of the Manufacturing PTC for Eligible Components that are sold in taxable years beginning after July 4, 2025 (i.e., 2026 for calendar year taxpayers) and on or before the publication of the forthcoming safe harbor tables and other guidance under the Material Assistance Limitation.

## Key Takeaways from the Notice

- Supply chain clarity. The Notice clarifies the extent to which a project owner or manufacturer (and their lenders, investors, or credit purchasers) must examine relevant supply chains for purposes of the Material Assistance Limitation. For Qualified Facilities and ESTs, developers will be required to analyze Direct Costs with respect to MPs (i.e., first-level components) and MPCs (i.e., components of an MP) incorporated into the project, without being required to track costs to underlying subcomponents or raw materials. By contrast, for Eligible Components, manufacturers will be required to travel farther up the supply chain given the requirement to analyze Constituent Materials (i.e., constituent elements and materials).

- The interim safe harbors allow taxpayers to breathe a sigh of relief . . . Similar to the domestic content safe harbor, we expect market participants to apply the Identification Safe Harbor and Cost Percentage Safe Harbor in any circumstance where they are available. These safe harbors operate as alternative compliance methods to full Direct Cost/Direct Materials Cost accounting and are intended to simplify cost tracking, supply chain due diligence, and recordkeeping. As a result, they should make compliance with the Material Assistance Limitation more administrable. For the same reasons, lenders, investors, and tax credit buyers should benefit from a reduced due diligence scope when project owner or manufacturer utilizes these safe harbors.

- . . . but the Identification Safe Harbor and the Cost Percentage Safe Harbor will not be universally available . . . The Identification Safe Harbor and the Cost Percentage Safe Harbor will be available only for a limited subset of Qualified Facilities (solar, battery, onshore wind, and hydro/pumped storage) and Eligible Components (solar modules, batteries with cells, and certain types of inverters). By confining the safe harbors to this limited set of projects and components, the Notice leaves large segments of the market with Direct Cost/Direct Material Cost accounting, which will lead to increased administrative burden and reduced compliance certainty under the Material Assistance Limitation. On the other hand, simplified tracking conventions (de minimis assignment-based tracking and average cost tracking for small ESTs and Eligible Components) may provide taxpayers with a workable alternative to the default accounting rules.

- . . . and the Certification Safe Harbor may be subject to practical limitations. The Certification Safe Harbor will be available for taxpayers that are unable (or choose not to) utilize the Cost Percentage Safe Harbor.[16] The Certification Safe Harbor will allow taxpayers to rely, in whole or in part,[17] on certifications from direct suppliers relating to the origin of MPs, MPCs, or Constituent Materials or the allocation of Direct Costs/Direct Materials Costs to PFEs, which should ease compliance. However, the practical utility of Certification Safe Harbor will depend on whether direct suppliers (including non-US suppliers) have complete and correct information about their upstream supply chain and whether these suppliers are willing to provide this information to project owners and manufacturers, despite potential exposure to penalties for inaccurate certifications.

[16] However, taxpayers utilizing the Cost Percentage Safe may be motivated to provide a safe-harbor-styled certificate to evidence that an MP, MPC, Eligible Component, or Constituent Material is not PFE Produced or PFE Sourced, even though the Certification Safe Harbor is not technically available.

[17] We expect future guidance to clarify the application of the Certification Safe Harbor when it is partially applied.

- Effective Control guidance provides (inconvenient) clarity. Outside of the Material Assistance Limitation, the Notice confirms that any intellectual property license entered into (or modified) on or after July 4, 2025 with an SFE could give rise to Effective Control. Taxpayers and commentators (including this one) have questioned whether classifying such a broad category of licenses as giving rise to Effective Control—regardless of the nature or substance of the agreement—was an inadvertent slip of the pen. Regardless of whether Congress, in fact, intended this result, the Notice makes clear that project owners and manufacturers will need to be wary (and exercise appropriate caution) when entering into intellectual property licenses with counterparties that are, or could be, PFEs. It remains unclear what standard will be used to determine whether an intellectual property license has been "modified" for this purpose.[18]

- The Notice is a good start to solving the FEOC puzzle—but significant questions remain. The Notice provides helpful guidance on a number of key questions related to the Material Assistance Limitation and sets the precedent that Treasury and the IRS release FEOC guidance that is consistent with the OBBBA. However, taxpayers continue to lack clarity (or even workable rules) for determining SFE or FIE status or applying the Effective Control standard. The Notice represents a step in the right direction, but project owners and manufacturers (not to mention lenders, investors, and tax credit purchasers) continue to lack the necessary guidance to move forward confidently with projects and planning.

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[18] Perhaps the more precise question is whether the standard should be a "material modification" (see, e.g., Treasury Regulations Section 1.1001-1(a)), any modification (even if immaterial) as the language of the OBBBA suggests, or something in between.

If you have questions concerning the contents of this alert, or would like more information about Weil's Tax practice group, please speak to your regular contact at Weil or to the authors:

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