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The Knight Watch

Prohibited Foreign Entity Rules in the One Big Beautiful Bill Act

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The One Big Beautiful Bill Act (OBBA) was enacted on July 4, 2025. It included sweeping revisions that phase out tax credits for renewable energy projects and advanced manufacturing. It also included new Prohibited Foreign Entity Rules that restrict who may qualify for various tax credits, including the Investment Tax Credit (Code Sec. 45Y or ITC), the Production Tax Credit (Code Sec. 48E or PTC), the Advanced Manufacturing Tax Credit (Code Sec. 45X), the Zero-Emission Nuclear Power Production Credit (Code Sec. 45U), the Clean Fuel Production Credit (Code Sec. 45Z), and the Credit for Carbon Oxide Sequestration (Code Sec. 45Q). Taxpayers who wish to claim these tax credits for years beginning after OBBA's enactment—the 2026 calendar year for most taxpayers—must comply with these rules.

Under the new Prohibited Foreign Entity Rules, taxpayers seeking the credits listed above must determine if they are a “specified foreign entity” (SFE) or a “foreign-influenced entity” (FIE).¹ If a taxpayer is either one, then it will not qualify for the tax credits. These rules, sometimes referred to as the Entity Rules, require examining various factors, including the taxpayers’ ownership structure, debt structure, and who can exercise authority over the taxpayer through appointment to important roles, such as the Chief Executive Officer. Additionally, a new Payment Rule requires scrutinizing any payments that a taxpayer made to SFEs (or entities related to SFEs) under a contract or agreement that might permit such SFE to “exercise effective control over” the renewable energy project or the production of an eligible component.² Moreover, for purposes of claiming the ITC, PTC, or the Advanced Manufacturing Tax Credit, taxpayers must comply with rules that prohibit qualified facilities, qualified interconnection property, and eligible components from including any “material assistance from a prohibited foreign entity.”³ This is referred to as the Material Assistance Rule. The Material Assistance Rules will require that taxpayers analyze whether their suppliers are SFEs or FIEs.

This column provides a general overview of the Prohibited Foreign Entity Rules as they apply to the ITC, PTC, and Advanced Manufacturing Tax Credit. Not every nuance of these rules is discussed. Additionally, the U.S. Department of Treasury and Internal Revenue Service (IRS) have not issued any guidance on the

application of these rules. Nevertheless, taxpayers wishing to claim these credits must comply with the Prohibited Foreign Entity Rules following OBBB's enactment. While complex, these rules are workable with proper advanced tax planning. Taxpayers that wish to claim tax credits and suppliers that support potentially tax credit-eligible projects should contact a tax attorney to ensure compliance with these rules.

Entity Rules

Under the new Prohibited Foreign Entity Rules, taxpayers cannot claim the ITC, PTC, or Advanced Manufacturing Tax Credit for any tax years beginning after OBBB's enactment date if they are a SFE or a FIE.⁴ This section explains when the rules might consider a taxpayer a SFE or FIE. It also discusses a rule that provides some relief from the Prohibited Foreign Entity Rules for taxpayers that are publicly traded companies.

Specified Foreign Entities

A taxpayer is a SFE if it meets one of the following five criteria:

- (1) The taxpayer is a "foreign entity of concern" as defined under certain parts of the William Thornberry National Defense Authorization Act (NDAA) for fiscal year 2021 (FY 2021 NDAA);
- (2) The taxpayer is identified as a Chinese military company operating in the United States in accordance with the FY 2021 NDAA;
- (3) The taxpayer is included on the Uyghur Forced Labor Prevention Act Entity List;
- (4) The taxpayer is specified under Section 154(b) of the NDAA for fiscal year 2024; or
- (5) The taxpayer is a "foreign-controlled entity" (FCE).⁵ Taxpayers that seek the ITC, PTC, or Advanced Manufacturing Tax Credit should pay particularly close attention to whether they are a FCE under the Prohibited Foreign Entity Rules. The FCE rules require considering whether certain other SFEs are treated as controlling the taxpayer.⁶ If so, the taxpayer itself will be treated as an SFE.

Foreign-Controlled Entities

Under the Prohibited Foreign Entity Rules, a person is treated as a FCE if it satisfies one of five criteria:

- (1) It is "any level of government" of a Covered Nation⁷;
- (2) It is an "agency or instrumentality" of a government of a Covered Nation⁸;
- (3) It is a "citizen or national" of a Covered Nation, unless that person is also a United States citizen, national, or Green Card holder⁹;

- (4) It is "an entity or qualified business unit (as defined in Code Sec. 989(a) [of the Internal Revenue Code]) incorporated or organized under the laws of, or having its principal place of business in a [C]overed [N]ation"¹⁰; or
- (5) It is "controlled" by an entity described in any of the previous four sentences.¹¹

For purposes of the Prohibited Foreign Entity Rules, an entity is treated as being "controlled" by another entity if more than 50 percent of its stock, capital or profits interest, or beneficial interests (depending on the entity type) is owned by another entity.¹² The Prohibited Foreign Entity Rules require taking into consideration the upward attribution rules of Code Sec. 318(a)(2) when determining ownership.¹³

Taxpayers who wish to claim the ITC, PTC, Advanced Manufacturing Tax Credit, Zero-Emission Nuclear Power Production Credit, Clean Fuel Production Credit, or the Credit for Carbon Oxide Sequestration must comply with the Prohibited Foreign Entity Rules.

Foreign-Influenced Entities

The Prohibited Foreign Entity Rules look to ownership of and control over an entity to determine if it is a FIE. It is possible that an entity is both a SFE and FIE. Specifically, an entity is a FIE if it meets one of the following criteria:

- (1) A SFE has "direct authority" to appoint a "covered officer." Covered officers include, among other things, board members, executive-level officers, and individuals having similar powers or responsibilities to board members or executive-level officers;
- (2) One SFE owns 25 percent or more of the entity;
- (3) Multiple SFEs own, in the aggregate, 40 percent or more of the entity; or
- (4) 15 percent or more of the entity's debt, in the aggregate, was issued to one or more SFEs.¹⁴

Additionally, under the Payment Rule, an entity is a FIE if it made a "payment" to a SFE, during the previous taxable year, under a "contract, agreement, or other arrangement"

that “entitles” the SFE to “exercise effective control over” certain aspects of an entity’s operations.¹⁵ In the case of taxpayers that construct a “qualified facility” for purposes of the ITC or PTC, or an “energy storage technology” for purposes of the ITC, such taxpayers are FIEs if a SFE “exercises effective control over” the qualified facility or energy storage technology.¹⁶ For purposes of the Advanced Manufacturing Tax Credit, a taxpayer that produces an eligible component is a FIE if a SFE exercises effective control over “the extraction, processing, or recycling of any applicable critical mineral” or “the production of an eligible component which is not an applicable critical mineral.”¹⁷

While these rules are complex, they are also workable with proper advanced tax planning. Taxpayers that wish to claim these credits—and the suppliers that support them—should contact a tax attorney to ensure compliance with these rules.

Generally, the Prohibited Foreign Entity Rules provide that “effective control” means agreements that provide a contractual counterparty (*i.e.*, the SFE receiving a payment from a taxpayer under a contract) with a certain level of authority over production of an eligible component, the energy generation in a qualified facility, or energy storage.¹⁸ OBBB instructs the Secretary of the Treasury to issue guidance related to the provision defining “effective control.”¹⁹ In the meantime, however, various examples of “effective control” are provided in the statute.²⁰ The Payment Rule also includes special consideration of licensing agreements that are not addressed here.

Publicly Traded Entities

Some publicly traded companies are relieved from parts of the Prohibited Foreign Entity Rules. For example, the rules generally do not treat an entity as a FCE if its securities are regularly traded on one of the following:

- (1) A national securities exchange registered with the Securities and Exchange Commission (SEC);
- (2) The national market system established pursuant to Section 11A of the Securities and Exchange Act of 1934; or
- (3) Certain foreign exchanges or markets that the Secretary of the Treasury determines have met certain standards under guidance set forth under Code Sec. 1296(e)(1)(A)(ii) (excluding those incorporated in, organized under the laws of, or with its principal place of business in a Covered Nation).²¹

Nevertheless, the rules deem publicly traded companies as FCEs if they are controlled by one or more SFEs that are each required to report their beneficial ownership under Rule 13d-3 of the Securities and Exchange Act of 1934.²²

Additionally, the rules generally do not treat an entity as a FIE if its securities are regularly traded on a market or exchange described above, or if at least 80 percent of its equity securities are owned, either directly or indirectly, by another entity whose securities are regularly traded on such a market or exchange.²³ Nevertheless, the rules deem publicly traded companies as FIEs if a SFE has authority to appoint a covered officer, one SFE that is required to report its beneficial ownership under Rule 13d-3 of the Securities and Exchange Act of 1934 (or certain equivalent rules) owns at least 25 percent of the taxpayer, more than one SFE that is required to report its beneficial ownership under Rule 13d-3 owns (in the aggregate) 40 percent of the company, or if a SFE owns more than 15 percent of the company’s publicly traded debt.²⁴

Material Assistance Rules

Material Assistance Cost Ratio

The Prohibited Foreign Entity Rules also restrict the amount of manufactured products (in the case of the ITC and PTC) or inputs into eligible components (in the case of the Advanced Manufacturing Tax Credit) that may come from a PFE for purposes of qualifying for tax credits.²⁵ The Material Assistance Rules require that taxpayers calculate the ratio of certain direct costs attributable to non-PFEs against certain direct costs attributable to all suppliers.²⁶ If the ratio exceeds thresholds set forth in the statute, then the taxpayer is not treated as receiving material assistance from a PFE. Under the Prohibited Foreign Entity Rules, the percentage of manufactured products or inputs into eligible components that must come from non-PFE sources gradually increases each year. So, the Material Assistance Rules will likely have the effect of requiring that taxpayers seek out alternative suppliers if a material portion of their existing suppliers are PFEs.

While similar in many ways, the Material Assistance Rules that apply for ITC and PTC purposes are slightly

different from the rules for purposes of the Advanced Manufacturing Tax Credit. Notably, the rules for the ITC and PTC require that taxpayers consider their “direct costs” when performing the ratio calculation.²⁷ By comparison, the rules for the Advanced Manufacturing Tax Credit require that taxpayers consider their “direct materials costs.”²⁸ To determine “direct materials costs,” the Prohibited Foreign Entity Rules direct taxpayers to consider Treasury regulations issued under the Uniform Capitalization Rules of Code Sec. 263A.²⁹ Similar rules would seem to apply for purposes of determining “direct costs,” which are described in the Treasury Regulations issued under Code Sec. 263A as including only direct materials costs and direct labor costs. Taxpayers and suppliers with questions about what costs are direct costs or direct materials costs should contact a tax attorney for assistance.

Material Assistance Rule Safe Harbor

Finally, the Material Assistance Rules require that the Secretary of the Treasury issue “safe harbor tables” no later than December 31, 2026 to help taxpayers determine the percentages of direct costs (or direct materials costs) that are attributable to PFEs.³⁰ In the meantime, these rules permit taxpayers to use guidance issued by the IRS in connection with the Domestic Content Bonus to determine percentages of direct costs.³¹ Additionally,

taxpayers are permitted to rely on certifications by their suppliers regarding the direct costs attributable to non-PFE sources or “that such product or component was not produced or manufactured by a [PFE].”³² OBBB provides a list of requirements for certifications that taxpayers must follow in order to rely on them for purposes of the safe harbor.³³ Although the Material Assistance Rules allow taxpayers to rely on a certification for purposes of claiming tax credits, taxpayers should still perform their own due diligence to ensure their direct costs attributable to PFEs do not exceed the permitted ratio.

Conclusion

Taxpayers who wish to claim the ITC, PTC, Advanced Manufacturing Tax Credit, Zero-Emission Nuclear Power Production Credit, Clean Fuel Production Credit, or the Credit for Carbon Oxide Sequestration must comply with the Prohibited Foreign Entity Rules. While these rules are complex, they are also workable with proper advanced tax planning. Taxpayers that wish to claim these credits—and the suppliers that support them—should contact a tax attorney to ensure compliance with these rules. Holland & Knight will continue to monitor for additional guidance from the U.S. Department of the Treasury and IRS about the application of these rules.

ENDNOTES

¹ See H.R. 1, 119th Cong. §70512(c) (2025) (enacted as Pub. L. No. 119-21) (to be codified at Code Sec. 7701(a)(51)). For ease, further citations are to the section of the Internal Revenue Code where the provision will be codified.

² See Code Sec. 7701(a)(51)(D)(i)(II).

³ Code Secs. 45X(c)(1)(C), 45Y(b)(1)(E), and 48E(b)(6).

⁴ See Code Secs. 45X(d)(4)(A), 45Y(g)(13)(A), and 48E(d)(6)(A).

⁵ See Code Sec. 7701(a)(51)(B).

⁶ See *id.* Code Sec. 7701(a)(51)(C).

⁷ *Id.* Code Sec. 7701(a)(51)(C)(i).

⁸ *Id.* Code Sec. 7701(a)(51)(C)(ii).

⁹ *Id.* Code Sec. 7701(a)(51)(C)(iii).

¹⁰ Code Sec. 7701(a)(51)(C)(iv).

¹¹ *Id.* Code Sec. 7701(a)(51)(C)(v).

¹² See *id.* Code Sec. 7701(a)(51)(G).

¹³ See *id.* Code Sec. 7701(a)(51)(H).

¹⁴ See *id.* Code Sec. 7701(a)(51)(D)(i)(I).

¹⁵ Code Sec. 7701(a)(51)(D)(i)(II).

¹⁶ *Id.* Code Sec. 7701(a)(51)(D)(i)(II)(aa).

¹⁷ *Id.* Code Sec. 7701(a)(51)(D)(i)(II)(bb).

¹⁸ See *id.* Code Sec. 7701(a)(51)(D)(ii)(I)(aa).

¹⁹ *Id.* Code Sec. 7701(a)(51)(D)(i)(I)(bb).

²⁰ Code Sec. 7701(a)(51)(D)(i)(II).

²¹ See *id.* Code Sec. 7701(a)(51)(E)(i)(I).

²² See *id.* Code Sec. 7701(a)(51)(E)(ii).

²³ See *id.* Code Sec. 7701(a)(51)(E)(i)(II).

²⁴ See *id.* Code Sec. 7701(a)(51)(E)(iii).

²⁵ See generally Code Sec. 7701(a)(52).

²⁶ See *id.* Code Sec. 7701(a)(52)(D).

²⁷ *Id.* Code Sec. 7701(a)(52)(D)(i).

²⁸ *Id.* Code Sec. 7701(a)(52)(D)(ii).

²⁹ See *id.*

³⁰ Code Sec. 7701(a)(52)(D)(iii)(I).

³¹ See *id.* Code Sec. 7701(a)(52)(D)(iii)(II)(aa).

³² *Id.* Code Sec. 7701(a)(52)(D)(iii)(II)(bb).

³³ See *id.* Code Sec. 7701(a)(52)(D)(iii)(IV).

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