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IRS Issues Final Regulations on Prevailing Wages and Registered Apprenticeship Requirements

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On June 18, the Treasury Department (Treasury) and the Internal Revenue Service (IRS) released final regulations (Final Regulations) on the prevailing wage and apprenticeship requirements under Section 45(b)(7) (Prevailing Wage Requirements) and (8) (Apprenticeship Requirements) and substantially similar provisions in other sections of the Code (collectively, the PWA Requirements), which were added by the Inflation Reduction Act of 2022 (IRA). Taxpayers must satisfy these requirements to qualify for enhanced credit amounts for several clean energy tax credits, including the investment tax credit under Code Sections 48 and 48E (ITC), the production tax credit under Code Sections 45 and 45Y (PTC), and the carbon capture and sequestration credit (Section 45Q Credit), unless construction on the facility began before January 29, 2023, or the applicable facility has a maximum net output of less than 1 MW(ac). In the case of the ITC and PTC, such enhanced credit amounts are equal to the pre-IRA full credit amounts without application of any pre-IRA phasedowns.

The Final Regulations will become effective August 26 (60 days after their publication in the Federal Register on June 25) and will apply to taxable years ending after this date. The Final Regulations generally apply to qualified facilities placed in service in taxable years ending after, and the construction or installation of which begins after, the date the Final Regulations are published in the Federal Register. However, taxpayers may rely on the Final Regulations with respect to qualified facilities placed in service in taxable years ending on or before the date the Final Regulations are published, and qualified facilities that begin construction before the date Final Regulations are issued and are placed in service in taxable years ending after the date the Final Regulations are issued, if taxpayers follow the Final Regulations in their entirety and in a consistent manner.

Taxpayers may also rely on the proposed regulations released by Treasury and the IRS on August 30, 2023 (Proposed Regulations), which we addressed in our prior alert, with respect to the construction of a qualified facility beginning on or after January 29, 2023, and on or before the date the Final Regulations are published in the Federal Register, if taxpayers follow the Proposed Regulations in their entirety and in a consistent manner beginning after October 28, 2023 (*i.e.*, the date that is 60 days after August 29, 2023).

The Final Regulations do not include final regulations regarding the PWA Requirements under Section 48 (the ITC), but indicate that Treasury and the IRS intend to issue final regulations with respect to the PWA Requirements in the Section 48 proposed regulations released by Treasury and the IRS on November 22, 2023 (Section 48 Proposed Regulations), which we addressed in a prior alert.

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Analysis

The Final Regulations are substantially similar to the Proposed Regulations, with certain significant changes, clarifications, and other items of interest to taxpayers, including:

- Exclusion of any work performed before January 29, 2023 (the date that is 60 days after the publication of Notice 2022-61) from the PWA Requirements.
- Beginning of Construction standard for when the PWA Requirements apply.
- Taxpayer responsibility for contractor and subcontractor compliance.
- Special rules for Indian Tribal governments.
- Wage determination timing.
- Supplemental wage determination timing.
- Construction, alteration, or repair exclusions.
- Clarification of maintenance as compared to repairs.
- Laborers or mechanics that cannot be located.
- Intentional disregard factors.
- Prevailing Wage penalty waiver.
- Scope of Apprenticeship Requirements.
- Labor Hours Requirement.
- Participation Requirement.
- Good Faith Effort Exception.
- Recordkeeping and reporting requirements.

These items are discussed below, together with other noteworthy aspects of the Final Regulations.

- *Exclusion of any work performed before January 29, 2023 from the PWA Requirements*. Commenters expressed that it would be unfair to require taxpayers to comply with the PWA Requirements before guidance had been issued. Treasury and the IRS have provided a transitional rule that applies regardless of whether there is a beginning of construction exception to the requirements (as is the case for Section 45).

- This is most relevant with respect to Sections 45L (the new energy efficient home credit), 45Z (the clean fuel production credit), and 48C (the qualifying advanced energy project credit), which do not include a beginning of construction exception.

- *Beginning of Construction*. Commenters indicated that there is confusion regarding the precise scope of the PWA requirements (*e.g.*, when the obligation to comply arises) because the word "construction" has different meanings under the Davis-Bacon Act (DBA) and the IRS Notices regarding the beginning of construction (the BOC Notices). The Preamble acknowledges that some activities constituting construction under the DBA (*e.g.*, the demolition and removal of an existing structure), would be considered a preliminary activity that does not constitute construction under the BOC Notices. The Final Regulations provide that any activity that constitutes construction (as defined in the DBA) of a qualified facility marks the start of the obligation to comply with the PWA Regulations.

  - The Preamble explanation leaves certain questions open with respect to when the obligation to comply with the PWA Requirements commences, including whether work constitutes construction (within the meaning of DBA) of a qualified facility in a situation where on-site work that is performed is capitalized to an asset other than a qualified facility (in the case of the PTC). It is possible this question will be clarified in the context of the ITC in Final Regulations issued pursuant to Section 48.

- *Taxpayer responsibility for contractors and subcontractor compliance*. Commenters requested guidance concerning whether the taxpayer is responsible for ensuring the compliance with the PWA requirements by contractors and subcontractors if the taxpayer may not be in privity of contract with all contractors and subcontractors. The Final Regulations retain the requirements in the Proposed Regulations that the taxpayer is solely responsible for the PWA Requirements and clarify that the responsibility extends to laborers and mechanics that it does not have privity with.

- *Indian Tribal governments*. Commenters raised various suggestions with respect to the applicability of the PWA Requirements to Indian Tribal governments. The Preamble states that the statutory language does not reflect an intent to allow Indian Tribal governments an exemption from the PWA Requirements or to substitute their own prevailing wage rate for DBA rates. However, the Final Regulations provide (i) an Indian Tribal government is excepted from the Prevailing Wage Requirements with respect to laborers and mechanics that are employees of the Indian Tribal government, and (ii) Indian Tribal governments that perform work subject to the PWA Requirements on Indian land that encompasses or overlaps more than one geographic area may choose the applicable wage determination for any of one the relevant geographical areas.

- *Wage determinations timing*. The Proposed Regulations would have provided that the applicable prevailing rates are determined at the time construction, alteration, or repair of the qualified facility begins. The Final Regulations provide that the applicable prevailing rates are determined at the time a contract for the construction, alteration, or repair of the facility is executed by the taxpayer and a contractor, and such prevailing rates apply to all subcontractors of the contractor. For contracts for alteration or repair over an indefinite period of time not tied to completion of specific work, prevailing wage rates must be updated annually.

  - In the Preamble, Treasury and the IRS acknowledge the need for taxpayers to reduce uncertainty and determine expected labor costs before entering into contracts for the construction of a facility. This change

will limit the circumstances in which prevailing rates need to be updated after the execution of a contract to situations in which the contract is modified to include additional substantial construction, alteration, or repair, or to require work to be performed for an additional time period, including the exercise of an option to extend the term of a contract.

  - The Final Regulations clarify that a new general wage determination is required to be used if the contract between the taxpayer and the contractor is modified to include additional "substantial" construction, alteration, or repair not within the original scope of work, resolving a confusion created by the use of the term "substantial" to describe the rule in the preamble to the proposed regulations, but not in the proposed regulations themselves.

- *Supplemental wage determination timing*. The Final Regulations revise the Proposed Regulations to align the timing of requests to the Department of Labor Wage and Hour Division (WHD) for supplemental wage determinations or rates for additional classification with the contract framework adopted for general wage determinations. Under the Final Regulations, requests for supplemental wage determinations cannot be made more than 90 days before the date the contract between the taxpayer and a contractor is expected to be executed. Once issued, if a supplemental wage determination is not incorporated into a contract (or, in the absence of a contract, if construction does not start) within 180 calendar days from the date of issuance, the supplemental wage determination is no longer effective.

- *Construction, alteration, or repair exclusions.* The Final Regulations clarify that activities that are excluded from the DBA definition of construction, prosecution, completion, or repair are similarly excluded from PWA Requirements. However, the Preamble affirms that specific installation work that occurs during the construction of a facility would be subject to the PWA Requirements consistent with the DBA.

  - The clarifying language is helpful, given that some developers and contractors have acted in reliance on the DBA exclusions, such as a material supplier exception for activities incidental to delivery and pickup, excluding certain work from the PWA Requirements. We note that the material supplier exception does not apply if an entity engages in construction activities other than those incidental to delivery and pickup (*e.g.*, an original equipment manufacturer installing its equipment).

- *Clarification of maintenance as compared to repairs.* The Final Regulations clarify the distinction between alteration and repair work, which is subject to the PWA Requirements, and maintenance work performed after the date a facility is placed in service, which is not subject to the PWA Requirements. Maintenance work is routinely scheduled and continuous or recurring, and normally involves the activity of keeping the facility in its current condition for continued use. Repair work normally includes an activity that: (i) improves the facility, either by fixing something that is not functioning properly or by improving upon the facility's existing condition; (ii) involves the correction of individual problems or defects as separate and segregable incidents and is not continuous or recurring; or (iii) improves the facility's structural strength, stability, safety, capacity, efficiency, or usefulness.

- *Laborers or mechanics who cannot be located*. While the preamble to the Proposed Regulations referenced an

expectation that taxpayers will be able to establish having made correction payments even if a former laborer or mechanic cannot be located, the Proposed Regulations did not provide a regulatory exception. The Final Regulations provide that a taxpayer may establish that correction payments have been made to a laborer or mechanic that cannot be located by demonstrating compliance with the applicable state unclaimed property law and all federal and state withholding and information reporting requirements with respect to the payments.

- *Intentional disregard factors.* The Proposed Regulations provided nonexhaustive lists of factors that may be relevant to the determination of whether a taxpayer's failures to meet the Prevailing Wage Requirements or Apprenticeship Requirements were due to intentional disregard, resulting in increased correction and penalty payments. The Final Regulations modify and expand the factors for each of the Prevailing Wage Requirements and the Apprenticeship Requirements. For the Prevailing Wage Requirements, some of the added factors include whether all laborers and mechanics were provided with a written notice of the rights conferred by the whistleblower provisions of the Taxpayer First Act and whether the taxpayer contracted with contractors that were known to be debarred for violations related to the underpayment of prevailing wages. For the Apprenticeship Requirements, some of the added factors include whether the taxpayer used and complied with an apprenticeship utilization plan, whether the taxpayer required contractors and subcontractors to forward to the taxpayer requests to registered apprenticeship programs within five business days of when requests are made, and whether taxpayers regularly reviewed contractors' and subcontractors' use of qualified apprentices.

- *Prevailing Wage penalty waiver.* The Proposed Regulations provided for limited penalty waivers in circumstances in which failures to satisfy the Prevailing Wage Requirements were small in amount or occurred in a limited number of pay periods. The Final Regulations modify the Proposed Regulation standards by providing the correction payment for a failure must be made by the last day of the first month following the end of the calendar quarter in which the failure occurred (rather than a period following when the taxpayer becomes aware of the failure) and the maximum underpayment must not exceed 5% (increased from 2.5%) of all amounts required to be paid to the laborer or mechanic in a calendar year. The Preamble notes that the revised correction period is intended to coincide with the due date for the filing of federal employment tax returns.

- *Scope of Apprenticeship Requirements*. The Final Regulations confirm that the Apprenticeship Requirements apply only to the construction of a qualified facility, including alteration and repair work that is performed prior to the facility being placed in service, and not to alteration or repair work occurring after the facility is placed in service. The Preamble includes reasoning that, while not explicitly stated, Section 45 suggests that taxpayers, contractors, and subcontractors may perform alteration and repair work that would be subject to the Apprenticeship Requirements, but that obligation only applies during construction and not after the facility is placed in service.

    - The clarification is a welcome relief to developers negotiating operations and maintenance agreements, as it provides support for the most widely held interpretation of the scope of the Apprenticeship Requirements pursuant to Section 45.

- *Labor Hours Requirement*. The Final Regulations clarify that, with respect to the PTC, the percentage of labor hours is calculated on a per qualified facility basis, rather than a project-wide basis.

- *Participation Requirement*. The Final Regulations confirm that the requirement that each taxpayer, contractor, or subcontractor who employs four or more individuals to perform construction, alteration, or repair work with respect to the construction of a qualified facility must employ one or more qualified apprentices applies over the entire course of construction, regardless of whether such taxpayer, contractor, or subcontractor employs four or more employees at the same location or at the same time.

- *Good Faith Effort Exception.* The Final Regulations require that, to satisfy the Good Faith Effort Exception, taxpayers, contractors, and subcontractors must make an initial request for qualified apprentice(s) from a registered apprenticeship program at least 45 days before the qualified apprentice is requested to begin work on the facility so that registered apprenticeship programs have adequate time to plan for the anticipated need. The Final Regulations also extend the time before an additional request needs to be made from 120 days to one year. Commenters requested guidance with respect to the application of the Good Faith Effort Exception if there is no registered apprenticeship program with a geographic area of operation that includes the location of the facility or that can be reasonably expected to provide apprentices to a project. The Final Regulations provide that if there is no registered apprenticeship program with a geographic area of operation that includes the location of the facility, trains qualified apprentices in the occupations needed to perform construction, alteration, or repair with respect to the facility, and has a usual and customary business practice of entering into agreements with employers for the placement of qualified apprentices in the occupation for which they are training, taxpayers will be deemed to satisfy the Good Faith Effort Exception for the apprentices they (or the contractor or subcontractor) would have requested for that occupation.

    - The Preamble notes that, given concerns about potential abuse of the Good Faith Effort Exception, taxpayers, contractors, and subcontractors should be mindful that requests that lack specific details of employment or do not reflect reasonable estimates will not be considered valid requests under the final regulations, and taxpayers need to keep records demonstrating the estimates included in the request were reasonable, such as projected and actual labor needs (both for journeyworkers and qualified apprentices) during the construction of the qualified facility, and any factors impacting those needs, such as apprentice utilization plans or contract requirements, as applicable.

    - The Preamble states that Treasury expects the application of the Good Faith Effort Exception in the absence of a registered apprenticeship program with an area of operation that includes the location of a facility to be rare because registered apprenticeship programs can operate across state and county lines and are expected to expand according to demands. Further, records sufficient to substantiate that there are no existing registered apprenticeship programs should be maintained, as well as documentation of the requests for apprentices that would have been made, including the specific work and hours that would have been performed by the apprentices if a registered apprenticeship program were available.

- *Recordkeeping and reporting requirements*. The Proposed Regulations provided enumerated lists of records, in addition to payroll records otherwise maintained, that may be sufficient compliance with the Prevailing Wage

Requirements and the Apprenticeship Requirements. The Final Regulations largely follow the approach in the Proposed Regulations but clarify and expand the lists. The Final Regulations also provide three alternatives to satisfy the recordkeeping requirements: (i) taxpayers may collect and physically retain redacted records from every relevant contractor and subcontractor; (ii) taxpayers may use a third-party vendor to collect and physically retain records from every relevant contractor and subcontractor on behalf of the taxpayer, and the records may have PII redacted to comply with applicable privacy laws; or (iii) taxpayers, contractors, and subcontractors may physically retain unredacted records for their own employees.

- The Final Regulations do not prescribe a particular form that must be utilized for recordkeeping but indicate that an accurately completed DOL Form WH-347 (the form used for public contracts subject to the DBA) may constitute a sufficient record reflecting the payment of prevailing wages.

- Under each of the alternatives noted above, unredacted records must be made available to the IRS upon request. The Preamble notes that taxpayers may not rely on certifications from contractors and subcontractors that they are complying with PWA requirements (including recordkeeping). Taxpayers may delegate certain recordkeeping activities to comply with applicable laws; however, the ultimate responsibility to ensure compliance with the PWA requirements remains with the taxpayer.

- Commentators stated that a subsequent determination by the IRS that additional work is covered by the PWA Requirements may create a circumstance in which a curative payment cannot be calculated because of the absence of records. In response, Treasury and the IRS affirmed that a failure to maintain adequate records does not excuse taxpayers from their obligations to comply with the PWA Requirements. Accordingly, taxpayers might find it valuable to take a conservative approach to recordkeeping requirements, even in situations where the applicable work may not be subject to the PWA Requirements.

Conclusion

The Final Regulations provide some helpful clarifications, but generally do not stray from the comprehensive system of data-driven compliance set forth in the proposed regulations. Treasury and the IRS continue a recent pattern of finalizing proposed regulations on IRA legislation with few significant changes. The issuance of the Final Regulations will bring a much-needed degree of certainty to the renewable energy industry and the service providers who are helping taxpayers to implement the PWA Requirements.

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