

IRS Issues Proposed Guidance on Advanced Manufacturing Production Tax Credit Under IRA

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On December 14, the Department of the Treasury and the Internal Revenue Service (IRS), issued proposed regulations providing guidance on the Advanced Manufacturing Production Credit (Section 45X Credit), established by the [Inflation Reduction Act of 2022](#) (IRA). The credit was established to incentivize production within the U.S. of eligible components related to the energy transition. The proposed regulations address many key points, including:

- The meaning of the term “produced by the taxpayer”;
- How sales to related persons can qualify for the Section 45X Credit;
- Costs considered in the production of certain materials in calculating the Section 45X Credit; and
- The introduction of an anti-abuse rule.

Comments on the proposed regulations must be received by February 13, 2024. A public hearing on the proposed regulations is scheduled for February 22, 2024.

The Section 45X Credit

The IRA introduced Section 45X to the Internal Revenue Code of 1986, as amended (Code), allowing taxpayers to qualify for the Section 45X Credit for the production within the U.S. and sale to an unrelated person of any “eligible components”. These eligible components, which are listed in Section 45X, include certain solar energy components, wind energy components, inverters, qualifying battery components, and applicable critical minerals. The amount of Section 45X Credit per eligible component varies based on the component type.

The Section 45X Credit is available for components produced and sold after December 31, 2022. It will begin phasing out for eligible components sold in 2030 and will fully phase out in 2032. There is no phase-out for the Section 45X Credit with respect to critical mineral production.

“Produced by the Taxpayer”

The proposed regulations provide a more thorough explanation of the requirement that an eligible component be “produced by the taxpayer.” For a component to be produced by the taxpayer, that taxpayer must significantly transform the constituent elements, materials, or subcomponents into a complete and distinct eligible component that is functionally different from the component that would result from mere assembly or superficial modification of

the elements, materials, or subcomponents. The proposed regulations also clarify that while the eligible component itself must be produced in the U.S., its constituent elements, materials, and subcomponents are not required to be.

The proposed regulations include a special rule for applying the “produced by the taxpayer” requirement for solar grade polysilicon, electrode active materials, and applicable critical minerals. With respect to those materials, “produced by the taxpayer” means processing, conversion, refinement, or purification of source materials, such as brines, ores, or waste streams, to derive a distinct eligible component.

The proposed regulations clarify that the taxpayer eligible to claim the Section 45X Credit is the taxpayer that directly performs the production activities. If the production of an eligible component is performed pursuant to a contract manufacturing arrangement, the party that may claim the Section 45X Credit is the party that performs the actual production activities. However, the proposed regulations include a special rule under which the parties to a contract manufacturing arrangement may determine, by agreement, which party may claim the Section 45X Credit. The IRS will not challenge the arrangement, so long as the certification statement requirements in the proposed regulations are followed.

- Parties to a contract manufacturing arrangement that want to utilize the special rule in the proposed regulations should be sure to carefully document their agreement with respect to which party may utilize the Section 45X Credit and comply with the requirements in the proposed regulations regarding the content of the certification statement.

Section 45X provides that a taxpayer is treated as producing an eligible component and selling it to an unrelated person if it is integrated, incorporated, or assembled into another eligible component that is then sold to an unrelated person. The proposed regulations clarify that the term “integrated, incorporated, or assembled” means the production activities described above, and does not include mere assembly or superficial modification of an eligible component.

Sales to Related Persons

The Section 45X Credit is generally available for eligible components sold within a taxable year, and typically applies only to eligible components sold to an unrelated person. For this purpose, related persons are those that are treated as being under common control within the meaning of the Treasury regulations under Section 52(b) of the Code. However, if a taxpayer sells an eligible component to a related person and the related person later sells the eligible component to an unrelated person, the taxpayer that sold the component to the related person will be treated as selling the component to an unrelated person. In addition, a taxpayer may make an election to treat a sale of an eligible component to a related person as if made to an unrelated person (Related Person Election). The Related Person Election must be made separately with respect to related person sales made by a taxpayer for each eligible trade or business of the taxpayer. If made, the Related Person Election is irrevocable and applies to all sales of eligible components to related persons produced by the taxpayer during the taxable year, with respect to each trade or business for which the Related Person Election is made.

- Like the [transferability election](#) under Section 6418 of the Code, the Related Party Election must be made on a timely (including extensions), originally filed return, though unlike the transferability regulations, the proposed Section 45X Credit regulations do not specifically address whether late-election relief is available.

- The IRS may require registration or other information to be provided in connection with the Related Person Election, as deemed necessary to prevent duplication, fraud, or any improper or excessive credit amount. The proposed regulations do not include detail as to the registration or other required processes.

Costs Considered When Calculating the Credit

For some eligible components (including critical minerals and electrode active materials), the Section 45X Credit is equal to 10% of the costs incurred by the taxpayer in the production of such materials. The proposed regulations address how to calculate the cost of production by reference to the rules under Section 263A of the Code. For this purpose, production costs may include both direct and indirect costs, excluding direct and indirect materials costs and costs related to the extraction of raw materials. The Preamble notes that production costs may include labor, electricity used in production, storage costs, depreciation or amortization, recycling, and overhead, but exclude costs of acquiring raw materials, and costs of materials used for conversion, purification, or recycling of the raw material.

- The exclusion of materials costs significantly limits the value of the Section 45X Credit for producing critical minerals and electrode active materials. Affected taxpayers should consider providing comments to the IRS in response to the proposed regulations.

Anti-Abuse Rule

Additionally, the proposed regulations include anti-abuse rules to prevent misuse of the Section 45X Credit. Under a general anti-abuse rule, the Section 45X Credit is not permitted if the primary purpose of the production and sale of an eligible component is to obtain the benefit of the Section 45X Credit in a wasteful manner, such as discarding, disposing of, or destroying the component without putting it to a productive use. There is also an anti-abuse rule for the Related Person Election, which would make the election unavailable where the eligible component is improperly used (*i.e.*, in the manner described above) by the related person.

- The Preamble notes that the anti-abuse rules are intended to address the scenario where the cost of producing certain eligible components is less than the amount of the Section 45X Credit.

Conclusion

The IRS continues to issue IRA guidance at a brisk pace, and the proposed regulations are particularly welcome guidance, given that the Section 45X Credit is new and the lead-time on design and construction of a production facility can be long. The proposed regulations clarify many points, but cast doubt on how much value the Section 45X Credit will add in the context of producing critical minerals and electrode active materials.

**Kimmy Fishman contributed to this article. Kimmy is not admitted to practice law; bar admission pending.*

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