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IRS Issues Proposed Regulations on Prevailing Wage and Apprenticeship Requirements under the IRA

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The Treasury Department (Treasury) and the Internal Revenue Service (IRS) published proposed 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. Treasury and the IRS previously issued Notice 2022-61, which set forth initial guidance on the PWA Requirements.

The proposed regulations would apply to facilities, property, projects, or equipment 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 these proposed regulations with respect to construction or installation of a facility, property, project, or equipment 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).

Overview of Requirements

In general, for qualified facilities that satisfy the PWA Requirements, the PTC or ITC is multiplied by five. In order to satisfy the Prevailing Wage Requirements, any laborers employed by the taxpayer or any contractor or subcontractor in the construction of a qualified facility, and with respect to any taxable year during the "relevant period," in the alteration or repair of such facility, must be paid wages that are not less than the prevailing wages for the construction, alteration, or repair of a similar character in the location in which such facility is located as most recently determined by the Department of Labor (DOL). For this purpose, the relevant period is the 10-year PTC period (12 years for Section 45Q carbon sequestration credits) or the five-year recapture period for the ITC. In order to satisfy the Apprenticeship Requirements, taxpayers must ensure that (i) the applicable percentage of the total labor hours of the construction, alteration, or repair of the qualified facility is performed by qualified apprentices (12.5% for facilities that begin after December 31, 2022 and before January 1, 2024, and 15% for facilities that begin thereafter), (ii) certain DOL (or applicable state agency) apprentice-to-journeyworker ratios are

met (*e.g.*, two journeyworkers for each apprentice) and (iii) every taxpayer, contractor, or subcontractor that employs four or more individuals to perform construction, alteration, or repair of the qualified facility employs at least one apprentice. The proposed regulations emphasize that the taxpayer who claims the enhanced PTC or ITC is solely responsible for satisfying these requirements and maintaining adequate books and records in support of its claim for the enhanced credit.

Prevailing Wage Requirements

To receive the increased credit, laborers or mechanics performing construction, alteration, or repair work on a facility must be paid wages at rates not less than the prevailing rates for construction, alteration, or repair of a similar character in the locality in which such facility is located, as most recently determined by the Secretary of Labor (Prevailing Wage Requirement). The terms "laborer" and "mechanic" mean those individuals whose duties are manual or physical in nature and include apprentices and helpers. The terms do not apply to individuals whose duties are primarily administrative, executive, or clerical, rather than manual. The proposed regulations clarify that maintenance work that is ordinary and regular in nature and designed to maintain existing functionality of a facility as opposed to an isolated or infrequent repair of a facility to restore specific functionality or adapt it for a different or improved use, is not considered "construction, alteration, or repair" work.

If the DOL has published a prevailing wage determination for the geographic area and type or types of construction applicable to a facility, including all labor classifications for construction, alteration, or repair work that will be performed by laborers or mechanics, that wage determination contains the prevailing rate upon which taxpayers may rely. If the construction of a facility spans two or more adjacent geographic areas, a taxpayer may satisfy the Prevailing Wage Requirement by ensuring that laborers and mechanics are paid wages at the highest rate for each classification provided under the general wage determinations, or may request a supplemental wage determination with respect to the facility. For offshore facilities, a taxpayer is permitted to rely on the general wage determination for the relevant category of construction that is applicable in the geographic area closest to the area in which the qualified facility will be located.

- The proposed regulations settle a common question that taxpayers have encountered after the issuance of Notice 2022-61, by providing that taxpayers are required to use the general wage determination in effect only when construction, alteration, or repair of the facility begins. Taxpayers are not required to update the applicable prevailing wage in the event that a new general wage determination is published by the DOL. However, use of a new general wage determination would be required when a contract is changed to include additional, substantial construction, alteration, or repair work not within the scope of the original contract, or to require work to be performed for an additional time period not originally obligated (including as a result of an option to extend the term of a contract for construction, alteration, or repair work). In addition, taxpayers must update the applicable wage rates, as necessary, with respect to any alteration or repair of a facility that begins after the facility is placed in service.

If the DOL has not published a prevailing wage determination for the geographic area and type of facility on www.sam.gov, or one or more labor classifications that will be performed by laborers or mechanics on the facility is not listed, the taxpayer must ensure that laborers and mechanics are paid wages at rates not less than those set forth in a supplemental wage determination or an additional classification and wage rate issued to the taxpayer by

the DOL upon request by the taxpayer, contractor, or subcontractor. The taxpayer, contractor, or subcontractor must submit the request to the DOL, Wage and Hour Division via email at IRAprevailingwage@dol.gov and provide certain information specified in the proposed regulations. Supplemental wage determinations and requests for prevailing wage rates for an additional classification should be requested no more than 90 days prior to the beginning of the construction, alteration, or repair of the facility, or (if construction has begun) as soon as practicable after determining the need for a supplemental wage determination or prevailing wage rate for additional classifications. If provided, a supplemental wage determining or prevailing wage rate for an additional classification applies retroactively to the date that the applicable construction, alteration, or repair work began.

- The preamble notes that a request for a prevailing wage rate for an additional classification would be appropriate only when the work to be performed by the classification is not performed by a classification in the applicable general wage determination and the classification is used in the area by the construction industry. The preamble notes that the DOL believes that most taxpayers will not need to request a supplemental wage determination or a rate for an additional classification because of the availability of general wage

Apprenticeship Requirements

To receive the increased credit, taxpayers must also ensure that, with respect to the construction of a facility, the following requirements set forth in Section 45(b)(8) and similar requirements in other applicable Code sections (Apprenticeship Requirements) are met:

- Labor Hours Requirement. The applicable percentage of the total labor hours of the construction, alteration, or repair work must be performed by qualified apprentices.

- Ratio Requirement. The Labor Hours Requirements is subject to any applicable requirements for apprentice-to-journeyworker ratios.

- Participation Requirement. Each taxpayer, contractor, or subcontractor employing at least four individuals to perform construction, alteration, or repair must employ at least one qualified apprentice.

For purposes of the Labor Hour Requirement, “labor hours” means the total number of hours devoted to the performance of construction, alteration, or repair work on a qualified facility by any individual employed by the taxpayer or by any contractor or subcontractor. Labor hours do not include hours worked by forepersons, superintendents, owners, or persons employed in bona fide executive, administrative, or professional capacities.

The proposed regulations clarify the Ratio Requirement, noting in the preamble that the ratio is intended to ensure that there are enough journeyworkers to oversee the work of apprentices. The proposed regulations confirm that the Ratio Requirement must be satisfied each day during construction, alteration, or repair of the facility for which apprentice labor hours are being claimed. If the Ratio Requirement is not met on any day, registered apprentices in excess of the applicable ratio who perform work on a facility must be paid the full prevailing wage rate for the

hours worked, and the hours worked by the apprentices on that day do not count as apprentice hours for purposes of the Labor Hours Requirement.

- The application of the Ratio Requirement on a daily basis will require very granular reporting and analysis.

- One could argue that the Ratio Requirement is not really a separate requirement. If the prescribed ratios are not satisfied, the result is not the loss of the enhanced credit amounts. Instead, the failure to satisfy the prescribed ratios changes how the Labor Hours Requirement and the Prevailing Wage Requirement apply.

The preamble clarifies that the Participation Requirement does not apply on a daily basis and does apply separately to the taxpayer and each contractor or subcontractor. The proposed regulations clarify that the total labor hours for which the Participation Requirement is not met is equal to the total labor hours worked by all individuals employed by the relevant party divided by the number of individuals employed by the relevant party.

- The proposed regulations do not appear to provide a *de minimis* requirement for satisfying the Participation Requirement. If that is correct, that could produce a strange disconnect between what is required to comply and the measurement of penalties for failing to comply. For instance, suppose a contractor employs four journeyworkers, each of whom works 240 hours. The total hours for which the Participation Requirement is not met is 240 ((4 * 240) / 4). But if the contractor had employed an apprentice for 40 hours, the Participation Requirement presumably would have been satisfied.

The IRA includes a good faith effort exception under which a taxpayer is treated as meeting the Apprenticeship Requirements if the taxpayer requests qualified apprentices from a registered apprenticeship program, and either the request is denied or the registered program fails to reply within five business days (the Good Faith Effort Exception). Notice 2022-61 provided little clarity on the exception, stating only that a taxpayer may meet the Good Faith Effort Exception if it requests qualified apprentices from a registered apprenticeship program in accordance with “usual and customary business practices” for registered apprenticeship programs in the particular industry. The proposed regulations add more detail with respect to the content and timing of the request and the scope of the exception. Specifically, the proposed regulations require the taxpayer, contractor, or subcontractor to make a written request to at least one registered apprenticeship program that has a geographic area of operation that includes the location of the facility or that can reasonably be expected to provide apprentices to the location of the facility, trains apprentices in the occupation(s) needed by the requesting party, and has a usual and customary business practice of entering into agreements with employers for the placement of apprentices in the occupation for which they are training, pursuant to its standards and requirements. The Good Faith Effort Exception is specific to the request for apprentices made in the request and applies only to the specific portion of the request that is denied or not responded to. If a request is denied, the proposed regulations require the taxpayer, contractor, or subcontractor to submit an additional request within 120 days of a previously denied request.

- The proposed regulations do not address what happens if a taxpayer cannot find any apprenticeship programs for the required classification and locality.

- An acknowledgement of receipt (written or otherwise) of the request by a registered apprenticeship program would constitute a response, and the taxpayer would not be able to rely on the Good Faith Effort Exception in such circumstances.

Correction and Penalty Payments

A taxpayer that otherwise fails to satisfy the PWA Requirements may be deemed to have satisfied the PWA Requirements if certain correction payments are made to laborers and mechanics paid at less than prevailing wage rates and the taxpayer pays penalty payments to the IRS. The proposed regulations provide that the PWA Requirements become binding only when the increased credit is claimed on a return. The obligation to make correction payments and pay penalties would not become binding until a return is filed claiming the increased credit, and the proposed regulations do not require payment of the correction payments or penalties until the time the increased credit is claimed. The earliest time a taxpayer can make a penalty payment to the IRS is at the time of filing a tax return claiming the increased credit. However, taxpayers may make correction payments to laborers or mechanics at any time after the initial payments were made and before filing a tax return to limit the amount of additional interest. The deadline for a taxpayer's ability to use the correction and penalty provisions to rectify a failure to comply with the Prevailing Wage Requirement is 180 days after the IRS makes a final determination that a taxpayer has failed to satisfy the requirements. For this purpose, a final determination occurs on the date the IRS sends the taxpayer a notice of such failure. Penalty payments for failure to meet the Prevailing Wage Requirements may be assessed and collected by the IRS without regard to the deficiency collection procedures of the Code, but those procedures apply to penalty payments made to satisfy the Apprenticeship Requirements.

- The preamble acknowledges that it may not be possible to locate all people to which correction payments must be made. However, the IRS and Treasury nevertheless decided not to provide a regulatory exception when none was provided in the statute. The preamble states that the IRS and Treasury "expect that taxpayers will be able to establish correction payments even when a former laborer or mechanic cannot be located", generally references that states have rules regarding unclaimed wages, and requests comments as to how to establish payment of correction amounts in this circumstance. Because the failure to comply with the corrective payment requirements could have catastrophic effects, this issue could cause concern for financing parties.

- With respect to credits transferred pursuant to Section 6418, the correction and penalty payment requirements apply to the eligible taxpayer (*e.*, the transferor of the tax credit). Although the proposed regulations are not entirely clear, it appears that an eligible taxpayer's failure to satisfy the correction and penalty payment requirements, when necessary, would result in a disallowance of the transferred credit.

- Correction payments and penalties may be increased if the IRS determines that the taxpayer acted with "intentional disregard." The proposed regulations provide a nonexhaustive list of facts relevant to determining whether a taxpayer acted with intentional disregard. This provides a roadmap of best practices that facility owners should consider including in relevant construction contracts.

The proposed regulations provide for limited penalty waivers in circumstances in which failures to satisfy the Prevailing Wage Requirement were small in amount or occurred in a limited number of pay periods. Specifically, the penalty payment requirement would be waived with respect to the construction, alteration, or repair performed by a laborer or mechanic during a calendar year if (i) the taxpayer makes the required correction payment by the earlier of (a) 30 days after the taxpayer became aware of the error or (b) the date on which the tax return claiming the increased credit is filed; and (ii) either (a) the laborer or mechanic is paid below the prevailing wage rate for not more than 10% of all pay periods of the calendar year (or part thereof) during which the laborer or mechanic worked on the facility or (b) the difference between the amount the laborer or mechanic was paid for the calendar year (or part thereof) during which the laborer or mechanic worked on the construction, alteration, or repair of the facility and the amount required to be paid for the calendar year is not greater than 2.5% of the amount required under the Prevailing Wage Requirement. In addition, the penalty would be waived with respect to both the Prevailing Wage Requirement and the Apprenticeship Requirements with respect to work performed under a qualifying project labor agreement and any correction payment owed to a laborer or mechanic is paid on or before a return is filed claiming an increased credit amount.

Recordkeeping Requirements

The proposed regulations clarify that records sufficient to establish compliance with the PWA Requirement include, at a minimum, payroll records for each laborer and mechanic performing construction, alteration, or repair work on the facility. In addition to such payroll records, the proposed regulations provide that records that demonstrate compliance with the Prevailing Wage Requirements may include the following for each laborer and mechanic (including qualified apprentices) performing such work on each qualified facility: identifying information, including name, EIN, address, telephone number and email address; the location and type of qualifying facility; the labor classification for determining the prevailing wage, including documentation in support of that determination; the hourly rates paid (including fringe benefits) for each labor classification; records supporting contributions to fringe benefits plans; the total number of labor hours worked for each pay period; total wages paid for each pay period; records supporting apprentice wages at less than prevailing wage, including records reflecting apprentice registration and program required wage rates and apprentice-to-journeyworker ratios; and records reflecting the calculation and payment of correction payments. To demonstrate compliance with the Apprenticeship Requirements, sufficient records include copies of any written requests to apprenticeship programs; agreements with a registered apprenticeship program; documents reflecting any registered apprenticeship program sponsored by the taxpayer, contractor or subcontractor; documents verifying participation in a registered apprenticeship program by each apprentice; records reflecting the required ratio of apprentices to journeyworkers prescribed by each registered apprenticeship program; the total number of labor hours worked by apprentices; and records reflecting the daily ratio of apprentices to journeyworkers.

- The preamble indicates that taxpayers would be required to establish compliance with the requirements at the time a return claiming the increased credit is filed. The preamble includes a list of information that Treasury and the IRS expect that taxpayers will be required to report at the time of filing a return, including relatively detailed information on the wages paid and hours worked for each laborer or mechanic classification (and total wages paid and hours worked by qualified apprentices for each classification).

Summary

Treasury and the IRS should be commended for continuing to issue guidance at an astonishing and unprecedented rate. The proposed regulations provide a relatively clear roadmap for complying with the PWA Requirements. But clear does not mean simple or easy; the compliance burden will be significant. The regulations require the gathering and maintenance of comprehensive data at a very granular level, which will in turn require the development and implementation of detailed processes and procedures for gathering, analyzing, and preserving the data. Facility owners will be looking to service providers, software solutions, and internal compliance and audit functions to help address these requirements.

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