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Keys to IRA Tax Breaks for US Green Energy, EV Production

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On Aug. 16, President Joe Biden signed the Inflation Reduction Act into law. The legislation includes landmark tax incentives for domestic energy production and manufacturing, with the goal of reducing carbon emissions in the U.S. by roughly 40% by 2030.

A significant aspect of the IRA is clear support for U.S. manufacturers of equipment used in renewable energy projects and electric vehicles through three powerful tax incentives:

- An advanced manufacturing production credit, for AMPC;
- An increased production tax credit, or PTC, and investment tax credit, or ITC, for energy projects that satisfy domestic content requirements; and
- An electric vehicle tax credit that is fully available only if (1) a required percentage of critical minerals in the EV's batteries are extracted or processed in the U.S. or a country with a U.S. free-trade agreement, or are recycled in North America, and (2) a required percentage of the EV's batteries are manufactured or assembled in North America.

With governmental support for U.S. manufacturing in the renewables sector at a historic high, potential investors in the industry are beginning to consider how the new legislation might affect their valuations of both established and emerging domestic manufacturers across a range of clean energy industries — from wind turbines, solar panels and battery storage, to EVs and EV charging stations, to processors of critical minerals such as nickel and lithium.

To aid in this analysis, we review the relevant tax credits below — and propose key questions that investors should ask in evaluating whether manufacturers can take advantage of these incentives.

Advanced Manufacturing Production Credit

The IRA's new AMPC is applicable to eligible components produced in the U.S. or a possession. The credit is only available if the eligible component is produced as part of the taxpayer's trade or business, and generally, it must be sold to an unrelated person — although related-party sales are permitted in certain situations, subject to additional guidance and clarification from the IRS.

Eligible components include specific components of solar, wind and battery projects, such as blades, inverters,

battery cells, photovoltaic wafers and solar modules, as well as certain critical minerals. Each eligible component is accorded a specified dollar amount of credit.

The AMPC phases down for most eligible components to 75% for sales in 2030, 50% for sales in 2031, 25% for sales in 2032 and 0% thereafter. A U.S. manufacturer is eligible for the AMPC for components produced and sold after Dec. 31 of this year.

U.S. manufacturers may, subject to certain limitations, elect to receive a direct cash payment of the AMPC. For certain U.S. manufacturers, the AMPC represents a potential cash flow source that otherwise would not be there, and should be considered when valuing an applicable company.

Domestic Content Enhancement

The PTC and the ITC are available for a wide range of renewable energy projects, including wind and solar farms. The IRA provides for an increased credit rate for PTC and ITC projects that satisfy domestic content requirements, including the requirement that any steel, iron or manufactured product incorporated in the facility or project be produced in the U.S.

Under the IRA, manufactured products are deemed to have been produced in the U.S. if not less than 40% — or 20% for offshore wind facilities — of the total costs of all such manufactured products incorporated in a facility or project are attributable to manufactured products, including components, which are mined, produced or manufactured in the U.S.

If these requirements are met, the increase in the PTC is 10% of the inflation-adjusted credit amount, and the ITC generally increases by 10 percentage points to 40% — i.e., 33% of the credit.

EV Credit Battery Sourcing Requirements

For vehicles placed in service between 2023 and 2032, the IRA replaces the existing EV tax credit with a new clean vehicle credit, worth up to $7,500 with two $3,750 components.

Component 1 will be met when a certain percentage of the critical minerals in the battery are extracted or processed in the U.S. or a country with a U.S. free-trade agreement, or are recycled in North America. The applicable percentage increases every year by 10% through 2027, when 80% of critical minerals in the battery must comply with these provisions.

Component 2 will be met when a certain percentage of the battery is manufactured or assembled in North America. Specifically, as of Jan. 1, 2024, at least 50% of the component parts of EV batteries must be produced or manufactured in North America. This increases by 10% each year through 2029, when 100% of battery contents must comply with these provisions.

Vehicles meeting one, but not both requirements, will be limited to a $3,750 credit.

In addition, the IRA excludes from the definition of “new clean vehicle” any vehicle placed in service after Dec. 31,

2024, whose battery contains critical minerals extracted, processed or recycled by a foreign entity of concern, and any vehicle placed in service after Dec. 31, 2023, whose battery contains components manufactured or assembled by a foreign entity of concern.

Foreign entities owned by, controlled by, or subject to the jurisdiction or direction of the government of China — currently the world's leading producer of battery components — are on the list of foreign entities of concern.

Practical Considerations for Investors

In view of the significant competitive advantage over foreign manufacturers that these tax incentives potentially represent, investors considering an investment in U.S. clean energy manufacturing should keep the following preliminary questions in mind:

- Does the manufacturer produce an item that is specifically enumerated in the AMPC? If so, are all the manufacturing processes associated with this item located in the U.S. or a possession?
- Does the manufacturer produce equipment that is used in projects that potentially qualify for the ITC or PTC — not just wind and solar, but also new qualifying technologies such as energy storage, and less-established technologies such as geothermal, biogas and biomass? If so, being able to meet the domestic content requirements can provide an important advantage over competitors, and gaining knowledge about the manufacturing processes and supply chain practices of the manufacturer — especially with respect to steel and iron components — is essential.
- If a U.S. manufacturer processes critical minerals for EV batteries, have these critical minerals been extracted or recycled outside of the U.S.? In many instances, establishing a U.S. origin for the critical minerals in EV batteries can provide a U.S. manufacturer with a competitive advantage over, for example, Chinese-recycled or Chinese-extracted critical minerals.
- To what extent does a manufacturer of an EV battery manufacture or assemble the battery in North America, and where do the components come from? Again, diligencing the supply chain practices of the battery manufacturer is crucial to validating whether the associated EV is eligible for a tax credit — and, thus, crucial to the valuation of the manufacturer.

All three tax incentives described above are expected to provide important support to U.S. manufacturers in the renewable energy and clean energy markets, creating new opportunities for investing in the U.S. energy transition. Optimizing these incentives requires a keen understanding of the IRA and the underlying industries.

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