

Locke Lord QuickStudy: IRS Issues Guidance on the Domestic Content Bonus Tax Credit Under the Inflation Reduction Act

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The Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) are steadily churning out guidance on the implementation of the Inflation Reduction Act’s (the “IRA”) expanded tax credits for renewable and other clean energy projects.^[1] Continuing this trend, Treasury and the IRS on May 12, 2023 released [Notice 2023-38](#) (the “Notice”) explaining what they intend to include in the forthcoming proposed rules regarding how wind, solar, battery storage and other renewable projects can qualify for the domestic content bonus credit under Sections 45, 45Y, 48 and 48E of the Internal Revenue Code (the “Code”).

In general, projects that are placed in service in 2023 or later that satisfy domestic manufacturing and sourcing requirements are eligible for a 10% bonus investment tax credit (“ITC”), which drops to 2% if the project does not comply with and is not exempted from the prevailing wage and apprenticeship requirements. For projects utilizing and qualifying for the production tax credit (“PTC”), the PTC is increased by 10%.^[2]

For a project to qualify for the domestic content bonus credit, the taxpayer must certify to the IRS that all steel and iron and a minimum percentage of all manufactured products that are components of the project were produced in the United States.^[3] That minimum percentage is referred to as the “adjusted percentage” and applies to the total cost of the manufactured product components. For qualified facilities that start construction before 2025, the adjusted percentage is 40%, increasing 5% each year until remaining at 55% for 2027 and beyond. A lower threshold applies to offshore wind facilities—20 percent, if construction starts before 2025, or 55 percent, if construction begins after 2027.

The Notice describes certain rules, summarized below, that Treasury and the IRS intend to issue in forthcoming proposed regulations later this year or early next year, which taxpayers may rely on for any qualified facility, energy project, or energy storage technology the construction of which begins before the date that is 90 days after the publication of any proposed regulations:

- 1. Domestic Content Requirements.** The Notice separates the domestic content requirements into two categories of project materials: (a) steel and iron construction materials (the “Steel or Iron Requirement”); and (b) manufactured products (the “Manufactured Products Requirement”).

(a) ***Steel and Iron Construction Materials.*** The Steel or Iron Requirement is met if, consistent with the Federal Transit Authority’s Buy America regulations (specifically, 49 C.F.R. § 661.5(b) and (c)), the Manufacturing Process with respect to any steel or iron items that are project components take place in the United States, except for metallurgical processes involving the refinement of steel additives.

The Steel or Iron Requirement applies to project components that are construction materials made primarily^[4] of steel or iron and provide structural or foundational support to a facility. However, the Steel or Iron Requirement does not apply to steel or iron used in any parts, components, or materials of manufactured products. By way of example, the Notice clarifies that items such as nuts, bolts, screws, and similar items that are made primarily of steel or iron but are not structural in function are not subject to the Steel or Iron Requirement. Structural project components subject to the requirement would include, for example, common components for solar or wind projects such as steel piles, racking, rebar and towers.

(b) **Manufactured Products.** The Manufactured Products Requirement is met if all Project components that are considered manufactured products are produced (or deemed produced) in the United States. Whether a manufactured product is deemed produced in the United States depends on whether the adjusted percentage of the total cost of all manufactured products is attributable to products which are mined, produced, or manufactured in the United States (the “Adjusted Percentage Rule”). Manufactured products are considered items produced as a result of the manufacturing process, which as specifically noted, is a process that alters and transforms parts or materials to create a new product that is “functionally different” from the result of “mere assembly” of such parts or materials.^[5]

For purposes of the Adjusted Percentage Rule, the percentage is produced by dividing the Direct Costs of the manufactured products made in U.S. factories by the cost of all manufactured products, whether foreign- or U.S.-produced. “Direct costs” are direct materials and direct labor costs paid by the manufacturer to produce the product, as provided in 26 C.F.R. § 263A-1(e)(2)(i). The Notice provides an example of the Adjusted Percentage Rule applied to a hypothetical project.

2. **Safe Harbor.** The Notice includes a “safe harbor” that identifies a non-exhaustive list of certain common components found in utility-scale solar, onshore and offshore wind and battery storage projects that would be classified under one of the two domestic content material categories.
3. **80/20 Rule for Retrofitted Projects.** The “80/20 Rule”, as defined by the IRS, dictates that, for purposes of the ITC or PTC, a facility may qualify as originally placed in service even though it contains some used property, if the fair market value of the used property is not more than 20 percent of the project’s total value, calculated by adding the cost of the new property to the value of the used property. The Notice adopts the 80/20 Rule for the domestic content requirement. A qualifying facility that is placed in service after 2022 and meets the 80/20 Rule will be eligible for a domestic content bonus amount if the new property meets the domestic content requirements.
4. **Certification Requirements.** To claim domestic content bonuses, taxpayers must certify to the IRS that they have satisfied the domestic content requirements on their annual return for the year the project is placed in service. The certification statement includes a description of the project, its placed in service date, and a calculation of the bonus credit as of such date; only costs incurred by the placed in service date for U.S. tax purposes will count toward the calculation of the credit. A copy must be included in subsequent returns where a taxpayer intends to claim the PTC on a project over multiple years.
5. **Substantiation.** The Notice confirms that a taxpayer reporting a domestic content bonus credit amount must meet the general recordkeeping and retention requirements under Section 6001 of the Code in order to substantiate that the domestic content requirements have been satisfied.

Conclusion:

What is clear from the guidance is that qualifying for the domestic content bonus will require a complicated calculation and analysis and detailed recordkeeping by the taxpayer as well as disclosure by manufacturers of all costs incurred to make a project's manufactured components, with itemized details down to wages and payroll taxes for labor and the materials and parts (and origins thereof) used to make such products. If a portion of the parts or materials that make up the manufactured product is imported, the costs of such parts or materials are excluded from the total U.S. Direct Costs for purposes of the calculation (but counted toward the total Direct Costs).

We expect some level of resistance from manufacturers in providing this level of information to taxpayers, at least until a new industry standard develops around domestic content reporting. It's also likely that manufacturers may increase pricing for manufactured products that satisfy the domestic content requirement in an effort to capture some of that value themselves. Meanwhile, developers and other industry stakeholders should carefully consider the nature and extent of certifications and indemnities to seek from manufacturers with respect to manufactured products qualifying for the bonus credit.

For questions regarding the IRA or the Notice, or to discuss these issues further, please contact the authors.

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[1] ?Public Law No. 117-169, 136 Stat. 1818 (August 16, 2022).?

[2] The prevailing wage and apprenticeship requirements affect the value of the PTC ?itself, as opposed to the size of the bonus credit as with the ITC.?

[3] For purposes of the Notice, the United States means the fifty U.S. States, the District of Columbia, the Commonwealth of Puerto ?Rico, Guam, American Samoa, the ?U.S. Virgin Islands, and the Commonwealth of the Northern Mariana Islands.?

[4] Notably, under the Buy America regulations, a 50% test applies to determine whether products are ??“predominantly” of iron or steel. Components made “*primarily*” of iron or steel must meet ?a 100% domestic content or manufacturing requirement.?

[5] See definition of “Manufacturing Process” under the Notice.

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