Articles + Publications | October 25, 2022

New IRA Tax Incentives for US Manufacturing in Renewable Energy Sector

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On August 16, President Biden signed the Inflation Reduction Act of 2022 (IRA) into law, which includes landmark tax incentives for domestic energy production and manufacturing with the goal of reducing carbon emissions in the United States by roughly 40% by 2030. A significant aspect of the IRA, described in detail in our summary, is clear support for U.S. manufacturers of equipment used in renewable energy projects and electric vehicles (EVs) through three powerful tax incentives:

- Advanced manufacturing production credit;
- Increased production tax credit (PTC) and investment tax credit (ITC) for energy projects that satisfy domestic content requirements; and
- EV credit that is fully available only if (1) required percentage of the "critical minerals" in the battery are extracted or processed in the United States or a country with a U.S. free-trade agreement or are recycled in North America and (2) required percentage of the battery is manufactured or assembled in North America.

Advanced Manufacturing Production Credit

The IRA adds a new advanced manufacturing production credit (AMPC) with respect to "eligible components" produced in the United States (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 December 31, 2022.

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 United States. Under the IRA, manufactured products are deemed to have been produced in the United States 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 United States. If these requirements are met, the increase in 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:

1. 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.

2. Component 2 will be met when a certain percentage of the battery is manufactured or assembled in North America; *i.e.*, as of January 1, 2024, at least 50% of the component parts of EV batteries must be produced/manufactured in North America, which 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 December 31, 2024 whose battery contains critical minerals extracted, processed, or recycled by a "foreign entity of concern" and any vehicle placed in service after December 31, 2023 whose battery contains components manufactured or assembled by a "foreign entity of concern." A foreign entity 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, is on the list of "foreign entities of concern."

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.

For additional information, please contact any of the attorneys listed in this advisory.

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