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Updated IRS Guidance on Critical Minerals and Battery Components Has Demonstrable, Ongoing Implications for Domestic and Foreign EV Manufacturing

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Introduction

On March 31, the Internal Revenue Service (IRS) issued highly anticipated proposed regulations on electric vehicle (EV) tax credits. Driven by an ambitious climate agenda, the Biden administration has incentivized domestic manufacturing over the last three years through the Bipartisan Infrastructure Law (BIL) and the Inflation Reduction Act of 2022 (IRA). Following a white paper issued by the Treasury Department in December 2022,[1] the IRS's proposed regulations embolden the administration's initiative and provide novel guidance on the requirements that EVs must meet to qualify for tax credits. The proposed regulations are critical for both domestic and foreign EV and battery producers, as well as companies engaged in mineral extraction and processing, and production of battery components.

Overview of IRA Amendments to Section 30D

Section 13401(a) of the IRA revised the statutory framework Section 30D furnishes by establishing Sections 30D(e)(1)(A) and 30D(e)(2)(A), each of which carry a maximum tax credit of $3,750 per qualifying "new clean vehicle."[2] Previously, tax credits under Section 30D were predicated on satisfying various charging capacity parameters for "new qualified plug-in electric drive motor vehicles."[3]

First, if an applicable percentage of the "applicable critical minerals" in the EV battery is (1) extracted or processed in the United States or in any country with which the United States has a "free trade agreement" in effect or (2) recycled in North America, the taxpayer is eligible for a $3,750 tax credit (the Critical Minerals Requirement).[4] The applicable percentage begins at 40% for qualifying vehicles "placed in service" prior to

January 1, 2024.[5] Each year thereafter, the applicable percentage increases, topping out at 80% for new clean vehicles placed in service from 2027 onwards.[6]

Second, if an applicable percentage of the value of the components of the EV battery is manufactured or assembled in North America, the taxpayer is eligible for a maximum tax credit of $3,750 (the Battery Components Requirement).[7] The applicable percentage begins at 50% for qualifying vehicles placed in service prior to January 1, 2024. Each year thereafter, the applicable percentage increases, topping out at 100% for new clean vehicles placed in service from 2029 onwards.[8] As a result of the forthcoming publication of the proposed regulations in the *Federal Register*, the Critical Minerals Requirement and Battery Components Requirement will apply to vehicles placed in service after April 17.

However, in some cases, these Section 30D credits are not available. Exceptions to the scope of "new clean vehicles" include: (1) any EV placed in service, beginning January 1, 2025, with a battery containing any applicable critical minerals that were extracted, processed, or recycled by a "foreign entity of concern,"[9] and (2) any EV placed in service, beginning January 1, 2024, with a battery containing any components that were manufactured or assembled by a "foreign entity of concern."[10] Section 40207(a)(5) of the BIL generally defines "foreign entity of concern" as any entity that is "owned by, controlled by, or subject to the jurisdiction or direction of" the governments of North Korea, China, Russia, and Iran.[11]

If a new clean vehicle meets both the Critical Minerals Requirement and the Battery Components Requirement and is not otherwise subject to the foregoing exclusions, it is eligible to receive the full $7,500 tax credit, assuming satisfaction of other criteria discussed in the proposed regulations, including North American vehicle assembly,[12] MSRP,[13] and taxpayer income thresholds.[14] Automakers will report directly to the IRS which EVs meet the Critical Mineral Requirement and/or Battery Component Requirement. On April 18, the IRS plans to definitively publicize specifically which EVs satisfy these requirements.

Proposed Regulations Under Section 30D

A. The Critical Minerals Requirement

The proposed regulations provide three discrete steps for determining whether a new clean vehicle meets the Critical Minerals Requirement.

First, manufacturers need to assess the "procurement chain" for each critical mineral in an EV battery.[15] A procurement chain is a common sequence of extraction, processing, or recycling activities that conclude in the production of "constituent materials," which include powdered anode and cathode active materials, foils, metals, solid electrodes, and binders.[16] The constituent materials delineate extraction, processing, and recycling from the subsequent assembly of battery components.[17] Each applicable critical mineral procurement chain is evaluated separately.[18]

Second, the proposed regulations instate a "50% of value added test" under which an applicable critical mineral is treated as a "qualifying critical mineral" extracted or processed in the United States or a country with which the United States has a free trade agreement if: (1) 50% or more of the value added to the applicable critical mineral by *extraction* is derived from extraction that occurred in the United States or a country with which the United States

has a free trade agreement in effect, or (2) 50% or more of the value added to the applicable critical mineral by *processing* is derived from processing that occurred in the United States or any country with which the United States has a free trade agreement in effect.[19] An applicable mineral is treated as *recycled* in North America if 50% or more of the value added to the applicable mineral by recycling is derived from recycling that occurred in North America. The 50% of value added test will apply this year and next after which the IRS anticipates moving to a more stringent test, reflecting the potential for more detailed tracking throughout manufacturers' supply chains.[20] Alternatively, the IRS may impose additional supply chain requirements on EV manufacturers for certification of compliance with the Critical Minerals Requirement.

Relatedly, the proposed regulations provide the following criteria to determine whether a country is considered to have a "free trade agreement" with the United States, including whether the agreement (1) reduces or eliminates trade barriers on a preferential basis, (2) commits the parties to refrain from imposing new trade barriers, (3) establishes high-standard disciplines in key areas affecting trade (*e.g.,* core labor and environmental protections), and/or (4) reduces or eliminates restrictions on exports.[21] The current list of such countries, which may be revised through published guidance, includes Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Japan, Jordan, South Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, and Singapore.[22] However, a comprehensive free trade agreement is *not* required to qualify. For instance, on March 28, Japan and the United States entered such an agreement restricted to minerals for batteries.[23] European Union or constituent member states may also execute similar trade agreements with the United States, bringing their extracted or processed critical minerals into compliance with the Critical Minerals Requirements.

Third, manufacturers must compute the qualifying critical mineral content. This metric is calculated as the percentage that results from dividing the total value of qualifying minerals by the total value of critical minerals. Qualified manufacturers would be required to select a date after the final processing or recycling step for determining the values associated with the total value of qualifying critical minerals and the total value of critical minerals. The date must be uniformly applied for all applicable critical minerals in the battery. The manufacturer may determine qualifying critical mineral content based on the value of the applicable critical minerals actually contained in the battery of a specific vehicle, or for purposes of calculating qualifying critical mineral content for batteries in a group of vehicles, average the qualifying critical mineral content calculation over a limited period of time (*e.g.,* a year, quarter, or month) with respect to vehicles from the same model line, plant, class, or some combination thereof, with final assembly within North America.

B. The Battery Components Requirement

Consistent with the white paper issued by the Treasury Department in December 2022, the proposed regulations define a "battery component" as a component forming part of a battery that is manufactured or assembled from one or more components or constituent materials that are combined through industrial, chemical, and physical assembly steps, including a cathode electrode, anode electrode, solid metal electrode, separator, liquid electrolyte, solid state electrolyte, battery cell, and battery module.[24] The definition of "battery" excludes any "constituent materials" and parts of the battery cell or module that do not contribute to the electrochemical storage of energy within the battery.

The proposed regulations set forth a four-step inquiry for determining the percentage of the value of the applicable

battery components in a battery. Qualified manufacturers must evaluate: (1) whether each battery component in a battery was manufactured or assembled in North America (*i.e.,* a "battery component for which substantially all of the manufacturing or assembly of which occurs in North America, without regard to the location of the manufacturing or assembly activities of the components that make up the particular battery component"), (2) the incremental value for each battery component, (3) the total incremental value of battery components, and (4) the percentage of the value of the battery components contained in the battery from which the electric motor of a new clean vehicle draws electricity that were manufactured or assembled in North America (the qualifying battery component content).[25]

The "qualifying battery component content" is the percentage that results from dividing the total incremental value of North American battery components (determined in Step 2) by the total incremental value of battery components (determined in Step 3). Qualified manufacturers would be required to select a date after the last manufacturing or assembly step for the battery components for determining the values associated with the total incremental value of North American battery components and the total incremental value of battery components. The date must be uniformly applied for all battery components contained in the battery. The manufacturer may determine qualifying battery component content based on the incremental values of the battery components actually contained in the battery of a specific vehicle, or for purposes of calculating the qualifying battery component content for batteries in a group of vehicles, may average the qualifying battery component content calculation over a limited period of time (*e.g.,* a year, quarter, or month) with respect to vehicles from the same model line, plant, class, or some combination thereof, with final assembly within North America.

Takeaways

- A pressing issue the proposed regulations do not address is the scope of a "foreign entity of concern" in Section 30D(d)(7). The IRS anticipates issuing guidance on this "at a later date."[26] However, many questions remain, including whether private Chinese businesses subsidized by or subject to government control meet the criteria. Considering the Biden administration's acknowledged focus on using the BIL and IRA to reduce dependency on Chinese supply chains, EV and battery producers and manufacturers should be prepared for a broad definition of "foreign entity of concern."

- It is unclear whether the Battery Components Requirement can be met through the assembly of subcomponents of a battery component into a battery component because the proposed regulations limit "assembly" of the battery component itself into "battery cells and modules," not all battery components.

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[1] *See* U.S. Department of the Treasury, "Anticipated Direction of Forthcoming Proposed Guidance on Critical Mineral and Battery Component Value Calculations for the New Clean Vehicle Credit" (Dec. 29, 2022), https://home.treasury.gov/system/files/136/30DWhite-Paper.pdf.

[2] *See* Inflation Reduction Act § 13401(c).

[3] *See* I.R.C. § 30D (2022).

[4] I.R.C. § 30D(e)(1)(A).

[5] Note that “placed in service” has the meaning assigned under proposed regulation § 1.30D-2(e). Specifically, “the date the taxpayer takes possession of the vehicle.”

[6] I.R.C. § 30D(e)(1)(B).

[7] I.R.C. § 30D(e)(2)(A).

[8] I.R.C. § 30D(e)(2)(B).

[9] I.R.C. § 30D(d)(7) (foreign entity of concern is defined in 42 U.S.C. § 18741(a)(5)).

[10] I.R.C. § 30D(d)(7).

[11] *See generally* 42 U.S.C. § 18741(a)(5)(c).

[12] Prop. Reg. § 1.30D-2(b), (d).

[13] Prop. Reg. § 1.30D-2(c).

[14] Prop. Reg. § 1.30D-4(b).

[15] Prop. Reg. § 1.30D-3(c)(14).

[16] Prop. Reg. § 1.30D-3(c)(6).

[17] Notice of Proposed Rulemaking, 2023-06822, p. 22-23.

[18] Prop. Reg. § 1.30D-3(c).

[19] Prop. Reg. § 1.30D-3(c)(17)

[20] Notice of Proposed Rulemaking, 2023-06822,, p. 21-22.

[21] Prop. Reg. § 1.30D-3(c)(7)(i).

[22] Prop. Reg. § 1.30D-3(c)(7)(ii).

[23] *See, e.g.*, David Lawder, “US, Japan sign trade deal on electric vehicle battery minerals,” *Reuters* (Mar. 28, 2023), https://www.reuters.com/business/autos-transportation/us-japan-strike-trade-deal-electric-vehicle-battery-minerals-2023-03-28/.

[24] Prop. Reg. § 1.30D-3(c)(5).

[25] Prop. Reg. § 1.30D-3(b).

[26] Notice of Proposed Rulemaking, 2023-06822, p. 33.

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