GE VERNOVA
Our portfolio of energy businesses

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Internal Revenue Service
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Room 5203
P.O. Box 5203, Ben Franklin Station
Washington, D.C. 20044

The Honorable Lily L. Batchelder
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, D.C. 20220

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Internal Revenue Service
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Washington, D.C. 20224

RE: Notice 2022-47, Notice 2022-50, and Notice 2022-51

Dear Madame Secretary and Mr. Paul:

GE Vernova, our portfolio of energy businesses, appreciates the opportunity to submit the following comments to the U.S. Department of Treasury (Treasury) and the Internal Revenue Service (IRS) on various of the clean energy tax credit provisions pursuant to Notices 2022-47, 2022-50, and 2022-51.

As the nation's leading energy and technology innovation company, GE Vernova is committed to supporting the success of the implementation of the Inflation Reduction Act of 2022 (IRA). GE Vernova strongly supports clean energy tax credits both because of the opportunity to reduce energy sector greenhouse gas emissions and to build a more expansive and resilient domestic energy supply chain, infrastructure, and grid that promote energy security. GE Vernova appreciates the opportunity to share these comments in support of swift implementation of the IRA to succeed in these goals.

Background

GE Vernova has pioneered technologies that have spurred world-transforming changes and improved the lives of billions. We are a world leader in power generation, transmission, and distribution solutions. Our technology produces one-third of the world's electricity, and our power generation equipment is

deployed in more than 140 countries. In addition, GE Vernova equips 90% of transmission utilities worldwide, and 40% of the world's electricity flows via our software. GE Vernova is actively involved in all segments of the energy sector and has long manufactured products designed to meet stringent government standards, while meeting customer requirements for efficient, reliable, resilient, and affordable energy.

GE Vernova is unique among U.S. companies in designing and manufacturing industry-leading wind, gas, steam, and hydro-powered turbines, nuclear power generation technologies, power quality equipment, and hybrid power solutions, while incorporating the latest digital innovation. GE Vernova leads grid modernization and resilience efforts with a defense-in-depth approach to the design, development, deployment, and service of the world's most critical power systems. We service the products we sell, and we offer equipment upgrades that increase our products' efficiency and availability. Finally, through our Global Research Center (GRC), our scientists and engineers are focused on developing and improving breakthrough technologies to accelerate the energy transition including hydrogen, carbon capture and sequestration, and small modular reactors.

We have always embraced our diverse portfolio of energy products and solutions across GE Vernova. In 2024, as we launch GE Vernova as a new, independent company, we will focus entirely on succeeding in the energy transition, will be represented by approximately 70,000 employees worldwide, and will use the combination of our technologies and expertise to help accelerate decarbonization efforts across the U.S., while supporting domestic energy manufacturing and jobs—today and in the future.

Summary

GE Vernova supports Treasury's and the IRS's efforts to issue prompt and thoughtful direction through guidance on the IRA energy provisions (Guidance) that will enable companies to act in the near term and set the stage for longer-term success. We strongly believe swift action will accelerate the IRA's implementation and thus accelerate decarbonization in the United States, while supporting and growing domestic energy manufacturing and domestic jobs.

We summarize below several key issues on which we are providing comments and recommendations to Treasury and the IRS. However, a more detailed/comprehensive list of guidance requests can be found in the attached Summary of Certain Guidance Requests by Topic. Finally, we have also attached briefing papers divided by each of the key subject areas.

The overarching theme of GE Vernova's comments is that Treasury and the IRS should leverage the Agency's own long-standing clean energy tax credit Guidance, regulations, rules, and procedures, as well as relevant existing laws and regulations established by other federal government agencies. This approach will accomplish several objectives: first, it will accelerate Treasury's and IRS's implementation of key IRA provisions; second, it will create greater certainty in the market, giving developers and investors needed comfort to proceed with projects; and third, it will clarify how manufacturers may comply with tax credit requirements, paving the way for much-needed investments in the domestic clean energy supply chain.

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We recognize Treasury and the IRS are focused on immediate-term issues to prompt swift action for certain tax credits. We look forward to continuing discussions with the Agency and providing technical support and perspectives on implementation of other IRA tax credits beyond the scope of the existing Notices.

Domestic Content Bonus Credit. The 10% domestic content bonus for the production tax credit (PTC) and the investment tax credit (ITC) has the potential to be a game-changing tool to grow the U.S. clean energy supply chain, but only if properly implemented. As the leading U.S. manufacturer of clean energy technology, we are optimistic about the potential for technologies to expand the volume of domestic content but need swift clarification of the details to ensure we are creating the right foundation at the outset. It is particularly critical to define the approach so that equipment manufacturers and other stakeholders can make meaningful investments in a vigorous U.S. supply chain. Furthermore, Guidance should prevent misuse of the tax credit by those who would invest in "manufacturing light" facilities, which would involve minimal assembly of content manufactured elsewhere. Guidance on domestic content should clarify the following points:

- **Scope of property to which domestic content applies**: A "qualified facility" under Section 45 and "energy property" under Section 48 should each be given their well-established definitions in the tax law. As these terms are well understood by taxpayers, this will ensure certainty and immediate understanding on how to comply with what qualifies for a credit. As the domestic content provisions are new to taxpayers, tying its requirements to existing rules as much as possible will enhance compliance and achieve the underlying goals for use of domestic product.

- **Requirements for iron and steel**: We support Guidance to confirm that a wind turbine tower, which supports the turbine and blades, is subject to the rules for steel and iron since the tower provides a support function. Furthermore, Guidance should confirm that certain items (such as nuts, bolts, flanges, etc.) are manufactured products or subcomponents of manufactured products and therefore are not subject to any steel or iron requirements.

- **Manufactured product**: Guidance should confirm that manufacturing involves the application of processes to alter the form or function of materials/elements to add value and transform materials/elements into a new product, which is significantly different from that which would result from mere assembly of the elements or materials. This clarification is consistent with the Buy America Act rules and will support the development of a strong domestic clean energy supply chain.

- **Repower**: Repowering of existing projects is important to achieving renewable energy and climate goals. Advances in technology allow for the productive reuse of older projects by repowering those projects, thus extending their useful lives and increasing their efficiency while reusing certain components (e.g., towers and foundations) of the original facility. Guidance should continue to recognize the value of "repowered" qualified facilities that satisfy the 80/20 rule and confirm through Guidance that the costs of manufactured components should include only the costs of the newly acquired manufactured components that are incorporated into the repowered qualified facility and not any value associated with the used property.

- **Bonus for other technologies**: Guidance should confirm that Section 45 qualified facilities, such as offshore wind or incremental hydropower, that make an election under Section 48(a)(5) to claim the ITC are eligible for the domestic content bonus credit. There is a technical drafting glitch that Treasury can resolve by applying the domestic content bonus to all Section 45 energy property that elect to claim the ITC.

Prevailing Wage and Apprenticeships. With 80% of the full credit value dependent on the prevailing wage and apprenticeship (PWA) requirements, these provisions must be defined in a way that promotes the intended goals of the IRA while enabling effective and pragmatic compliance. These requirements are new to many in the renewable energy industry, the nascent carbon capture industry, and other stakeholders under the IRA. Therefore, careful consultation with industry prior to issuing guidance is essential to obtain clarity and avoid vagueness and uncertainty while accelerating outcomes. As a leading U.S. employer of a clean energy workforce, we respectfully share the following perspectives:

- **Use of Davis-Bacon (when appropriate)**: IRS Guidance should act in conformity with Davis-Bacon, when appropriate, and thus avoid adding uncertainty and complexity to an already complicated issue. Guidance should apply the PWA requirements in a manner consistent with Davis-Bacon, as the statute indicates, but otherwise provide flexibility consistent with Congress' intent to mobilize renewable energy quickly and efficiently.

- **Definition and application of construction, alteration, and repair**: The terms "construction," "alteration," and "repair" are intended to cover construction activity as distinguished from manufacturing, furnishing of materials, or servicing and maintenance work. Guidance should define the phrase "construction, alteration, or repair" consistent with the tax law rules and exclude "incidental repairs" and "routine maintenance." Guidance should clarify that the phrase "construction, alteration, or repair," as used in the statute, applies only to work performed at the project site. Finally, Guidance should adopt a *de minimis* threshold for alteration and repair when it comes to prevailing wage rates.

- **Application of apprenticeships**: Apprenticeships serve as an important resource and tool, and we appreciate the well thought out structure of the provision. We request guidance should confirm that the apprenticeship requirement applies only to the construction of the qualified facility or energy project and does not apply to any period after such facility or project is placed in service.

Manufacturing Credits: Advanced Manufacturing Production Credit (45X). The IRA seeks to increase U.S. manufacturing of clean energy technologies. The new advanced manufacturing production credits (AMPC) under Section 45X promise to be central to achieving this objective while also preserving the existing clean energy supply chain. The proper implementation of this credit can position the U.S. as the global leader for clean energy manufacturing. Having clarity on the AMPC, especially defining the term "produced," may open the door for additional investments by suppliers in the short-term. Like the domestic content bonus requirements, which serve a parallel purpose, this credit should be interpreted in a similar manner so stakeholders make meaningful investments in a vigorous U.S. supply chain. Guidance should prevent misuse of the tax credit by those who would invest in "manufacturing light"

facilities, which would involve minimal assembly in the U.S. of content manufactured elsewhere. To that end, we suggest the following:

- **Definition of "produced"**: Guidance should define the use of the terms "produced" and "production" in § 45X in a manner consistent with manufacturing as it is applied to the domestic content bonus credit provisions and adopt the definition of the term "manufacturing process" set forth in 49 C.F.R. § 661.3. This clarification will support the development of a robust domestic clean energy supply chain that does not involve minimal assembly in the U.S. of content manufactured elsewhere.

- **Definition of "total rated capacity"**: The AMPC for wind components is calculated by multiplying the total rated capacity of the completed wind turbine by the amount designated in the law for each component (e.g., $0.02 per blade, $0.05 per nacelle). Capacity of a component varies. Guidance should clarify that the determination of the "total rated capacity (expressed on a per watt basis)" is applied at the time of the production and sale of the components based on the manufacturer's rated capacity, and this standard is not based on project-specific criteria. This clarity is needed so manufacturers of relevant components can achieve a consistent credit rate among their manufactured components and assure that site-specific operational conditions do not affect the credit amount.

- **Repower**: Guidance should address repowering and allow the credit amount for wind energy components, specifically the nacelle, even if the nacelle contains some used parts, provided the 80/20 rule under existing IRS guidance is otherwise satisfied.

Credit Monetization: Transferability. One of the key constraints to the growth of renewable projects in the U.S. will be availability of tax equity capacity. To expand the available pool of investors, appropriate clarification is required that will provide certainty on a number of issues and thereby facilitate transfers of tax credits. Providing clear guidance on the administration and application of transferability is an important priority that will ensure continued investments. Specifically, guidance should:

- Recognize that the transfer of an eligible credit may be made under a single transfer agreement with one or more transferee taxpayers that covers multiple taxable years and includes the entire 10- or 12-year credit period. This clarification will provide flexibility in raising capital when a project is first placed in service in order to discharge construction debt and redeploy capital for further development.

- Confirm that the transferee taxpayer(s) may pay for any such eligible credits to be transferred to them over the credit period on an upfront payment basis combined with annual payments for any excess credits produced (commonly referred to as "Paygo") in order to address any variability in production and applicable credits over the term of the transfer agreement.

- Confirm that the partners may agree that the partnership can elect to transfer the credits allocable to any partner, in whole or in part, and allow the partnership to specially allocate the tax-exempt income from the cash consideration received. To the extent that such a partnership

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otherwise satisfies the requirements of Rev. Proc. 2007-65, Guidance should clarify that the above transfer of credits and special allocations are consistent with the safe harbor provided by the revenue procedure.

- Adopt flexible procedures for taxpayers to supply information necessary to verify the transfer of eligible credits and to prevent errors and abuse.

Credit Monetization: Direct Pay. Direct pay is available to taxable entities with respect to the § 45V credit, the § 45Q credit, and the § 45X credit. Special rules are provided for partnerships owning these types of facilities. Guidance should address the following points:

- Given the intent to increase the domestic supply chain, we recommend guidance clarify, regardless of the 5-year period in § 6417(d)(1)(D)(ii), that the taxpayer is entitled to make the direct payment election on a facility-by-facility basis with respect to the § 45X credit.

- In addition, the current process for tax refunds is lengthy, and does not create the type of certainty and timing needed to make these large investments. To ensure that our existing tax processes do not unintentionally create disincentives to proceed, we welcome the opportunity to work with the Administration and other stakeholders on an expedited process for direct pay refunds.

Conclusion

We appreciate the opportunity to respond to this request for comments. A summary of certain guidance requests follows. We have also attached briefing papers for all issues divided by each of the key subject areas. GE Vernova is prepared to make its subject matter experts and its outside counsel available to Treasury and the IRS to discuss and explain each or any of these issues in detail. We look forward to engaging in discussion and providing assistance.

Best regards,

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Summary of Certain Guidance Requests by Topic

Each of these issues, along with additional issues, is fully discussed in the attached briefing papers divided by each of the key subject areas.

Domestic Content Bonus Credit. Guidance on domestic content should clarify the following points:

- Guidance should follow Congress' expressed intent that domestic content requirements for steel, iron, and manufactured products that are a component of a qualified facility is determined in a manner consistent with section 661 of title 49, Code of Federal Regulations. Note that the application of these rules is specific to determining whether steel, iron, and manufactured products are produced or manufactured in the United States and is not a wholesale importation of 661 of title 49 as it applies to certifications, waivers, rolling stock, and certain other provisions of that section.

- Application of the domestic content requirements will differ as to the scope of property to which the requirements apply based on whether the requirements are being applied to a Section 45 qualified facility or a Section 48 energy project. The scope of included property under these two credits differs. Domestic content for a "qualified facility" under Section 45 should be limited to the assets necessary to the production of electricity. In the case of a wind facility for purposes of Section 45, the term "qualified facility" should be defined in the same manner as the definition in Rev. Rul. 94-31 – i.e., each wind turbine together with its tower and supporting pad.

- In the case of an "energy project" or "energy property" under Section 48, the Guidance should provide that the domestic content requirement should be determined based on the whole of the qualified investment credit property that constitute steel, iron, or a manufactured product as those items are defined below. For energy property such as offshore wind or solar, this would generally include all of the assets included in the project up through the associated substation where the electricity is stepped-up to transmission voltage. It is important to note, of course, that certain property that qualifies for the ITC would not be taken into account because it is not steel, iron, or a manufactured product, such as service roads, storm water management, drainage facilities, earthen or concrete pads, and similar onsite constructed items.

- In the case of §§ 45Y and 48E, the scope of the property to which the domestic content bonus applies should correspond to scope of property under §§ 45 and 48, respectively.

- Guidance should confirm that any steel or iron requirements should be limited to construction materials made primarily of steel or iron that have a structural, load-bearing, or support function to the qualified facility.

- Guidance should confirm that steel or iron used in components or subcomponents of manufactured products is not subject to separate steel or iron standards for domestic content, but rather are subject to the manufactured products standard.

- Guidance should confirm that a wind turbine tower, which supports the turbine, is subject to the rules for steel and iron as the tower provides a support function for the turbine and blades.

- Guidance should confirm that items such as nuts, bolts, flanges, screws, washers, cabinets, covers, shelves, clamps, fittings, sleeves, adapters, tie wire, spacers, door hinges, and similar items that are made of steel or iron are non-structural in nature and/or subcomponents of manufactured products and therefore are not subject to any steel or iron requirements.

- Guidance should clarify that rebar and meshing made of steel or iron which is included in the supporting foundation is subject to the steel or iron standards. The supporting foundation for the wind turbine which is poured onsite is not a manufactured product and does not count as such.

- Guidance should confirm that manufacturing involves the application of processes to alter the form or function of materials or of elements of the product in a manner adding value and transforming those materials or elements so that they represent a new product functionally different from that which would result from mere assembly of the elements or materials.

- Guidance should confirm that the same categorization of items is made in a similar manner as the 49 C.F.R. 661 guidance – i.e., a qualified facility is categorized in terms of the end product(s), the manufactured products or components, and the subcomponents.

- Guidance should confirm, consistent with 49 CFR 661.5(d)(2), that the origin of the subcomponents of a component which is a manufactured product is disregarded for domestic content purposes; provided, however, that there is sufficient manufacturing at the component level.

- Guidance should confirm that the final assembly location for purposes of the "end product" definition and the location where the constituent components are directly incorporated is the project site.

- Guidance should address onsite manufacturing activities similar to the guidance in 49 CFR 661.11(d) – i.e., components generally cannot be manufactured at the final assembly location (i.e., the project construction site) unless the manufacturing process is separate and distinct from the assembly of the end product.

- Guidance should confirm that onsite construction activity, such as pouring concrete foundations, is not manufacturing and the cost of such construction activity is not taken into account in determining the applicable percentage of manufactured products. In contrast, preformed concrete pads or enclosures for inverters or other equipment that are manufactured offsite and delivered to the project site would be manufactured products.

- Guidance should confirm that the 40% adjusted percentage (20% in the case of offshore wind) compares the total costs of all the manufactured components (i.e., "the manufactured products which are components of a qualified facility") of U.S. origin to the total costs of all manufactured components whether of U.S. or foreign origin. Guidance should specifically confirm that the adjusted percentage does not require any comparison or allocation of domestic and foreign costs *at the component or subcomponent level* (i.e., the rule is not that 40% of the costs of the component or subcomponent must be U.S. origin in order to be treated as domestic).

- Guidance should clarify that total costs do <u>not</u> include property, items, or materials that are <u>not</u> incorporated into the qualified facility. For example, in the case of a wind facility for purposes of Section 45, the costs of pad-mount transformers, on-site power collection systems, monitoring

and meteorological equipment, site improvements, and similar assets, as well as costs allocated to those assets, are not included in the determination of the costs of the manufactured components of the qualified facility.

- Guidance should clarify that labor costs and similar costs incurred at the project site for the actual construction or final assembly of the qualified facility (e.g., contractor and subcontractor labor costs, profit, etc.) are construction costs that are not considered in determining the costs of manufactured components.

- Guidance should confirm that the cost of the manufactured component delivered to the project site is the total price charged by the manufacturer or other supplier to the project sponsor, developer, contractor, or owner, as the case may be. Guidance should confirm that costs of transporting manufactured components to the project site are included in the cost of the manufactured component. In other words, the cost that is taken into account is the delivered-to-the-site cost to the taxpayer/owner.

- Guidance should confirm the treatment of qualified facilities that are "repowered" and satisfy the 80/20 test. Guidance should confirm the costs of manufactured components should include only the costs of the newly-acquired manufactured components that are incorporated into the repowered qualified facility and not any value associated with the used property.

- Guidance also should confirm that domestic content requirements should apply *only* with respect to the "new" property incorporated into the qualified facility and should not apply to any of the used property from the existing facility. For example, in the case of a wind repowering project, if the used property includes the steel tower, the origin of the steel used in the existing tower should not be considered in determining whether the steel or iron requirements of § 45(b)(9)(B)(ii) are satisfied.

- Guidance should confirm in the case where the existing tower and foundation are reused, that the other components delivered to the job site to be installed into the repowered turbine are manufactured products for purposes of the domestic content requirements.

- Guidance should confirm that Section 45 qualified facilities, such as offshore wind or incremental hydropower, that make an election under Section 48(a)(5) to claim the ITC are eligible for the domestic content bonus credit.

Prevailing Wage and Apprenticeships. As a leading U.S. employer of a clean energy workforce, we respectfully share the following perspectives:

- Guidance should apply the PWA requirements in a manner consistent with Davis-Bacon, as the statute indicates, but otherwise provide flexibility consistent with Congress' intent to mobilize renewable energy quickly and efficiently.

- Guidance should specifically define the key terms "laborers and mechanics" and limit the scope of the employees required to be paid prevailing wage rates consistent with Davis-Bacon. Such definition would exclude off-site employees, foremen, superintendents, owners, executives, administrative personnel, and professionals, including architects, engineers, technicians, draftspersons, inspectors, and similar workers.

- Guidance should clarify that the terms "construction, alteration, or repair," as used in the statute, apply only to work performed at the project site.

- Guidance should provide that taxpayers, contractors, or subcontractors will be deemed to be in compliance with the PWA requirements in the case of Project Labor Agreements or other collective bargaining agreements that provide for negotiated non-standard wage rates. Such labor contracts would typically match or exceed a generally prevailing wage and taxpayers, contractors, or subcontractors are contractually precluded from paying workers a different amount from the agreed rates.

- Guidance should clarify that employees of the taxpayer are not required to be paid prevailing wages unless performing construction work that would typically be performed by a contractor's employees.

- The transportation of materials or supplies to or from the site of the work by employees of the construction contractor or subcontractor is not construction, alteration, or repair. Guidance should confirm that all offsite and *de minimis* onsite transportation work is not covered by PWA.

- The terms construction, alteration, or repair are intended to cover construction activity as distinguished from manufacturing, furnishing of materials, or servicing and maintenance work.

- Application of the PWA requirements to alteration or repair, after the qualified facility or energy project has been placed in service, should be limited in scope. Guidance should define the terms "construction, alteration, or repair" consistent with the tax law rules related to "incidental repairs" and "routine maintenance." Further, Guidance should adopt a *de minimis* threshold under which any alteration or repair work on a qualified facility or energy project will not require prevailing wages to be paid if the total amount paid by the taxpayer for such work is less than the greater of (i) $1,000,000, or (ii) 10% of the original capitalized cost of the qualified facility or energy project.

- Guidance should clarify that the terms "construction, alteration, or repair" generally do not apply to supply or service contracts (including any installation work associated with such contracts), offsite manufacturing work, preconstruction development work, and any other work that is incidental to the construction work at the site or *de minimis* in nature.

- Guidance should confirm that the PWA requirements apply only to laborers or mechanics employed directly upon the work site. Secondary sites, in the case of a qualified facility or energy project, should be limited to only those sites that are adjacent to the facility or project and should not extend to offsite areas except in exceptional circumstances.

- Guidance should confirm that transient workers who travel from project to project or to offsite headquarters or branch locations are only paid at prevailing wage rates for their time on the site of the work and adopt a *de minimis* standard to exempt employees who spend insignificant time onsite.

- Guidance should establish a process to provide certainty to taxpayers, contractors, and subcontractors with respect to the wage determination process and the construction classification of qualified facilities and energy projects.

- Guidance should specifically address situations in which the project construction site is located in multiple counties or localities and adopt flexible rules to eliminate the need for taxpayers, contractors, and subcontractors to track specific time spent in different geographic jurisdictions.

- Guidance should confirm that the apprenticeship requirement applies only to the construction of the qualified facility or energy project and does not apply to any period after such facility or project is placed in service.

Manufacturing Credits: Advanced Manufacturing Production Credit (45X). For advanced manufacturing credits, we suggest the following guidance:

- Guidance should define the use of the terms "produced" and "production" in § 45X in a manner consistent with produced in the U.S. with respect to manufacturing as it is applied to the domestic content bonus credit provisions. The Guidance should adopt the definition of the term "manufacturing process" set forth in 49 C.F.R. 661.3, incorporating the guidance applying this definition, for purposes of defining the terms "produced" and "production" in § 45X and applying the requirement in § 45X(d)(2) that production occur within the United States.

- Based on the appropriate test for domestic content, Guidance also should confirm, consistent with 49 C.F.R. 661.5(d)(2), that the origin of the subcomponents of an eligible component for the § 45X credit is disregarded.

- Guidance should adopt standards similar to those used in the 49 C.F.R. 661 rulemaking and guidance for determining whether there have been sufficient manufacturing processes at the component level versus mere assembly.

- Guidance should adopt appropriate protections with respect to so-called "onsite manufacturing." Foreign subcomponents should not cause the wind energy components in which they are incorporated to be treated as produced within the United States where the subcomponents are incorporated as part of installation or other construction activities at the project site. Onsite manufacturing should only be permitted, consistent with the BAA rules, where the manufacturing activities are separate and distinct from the installation and construction of the wind energy components at the project site.

- Guidance should define the terms "sale" and "sold," for the purpose of determining the timing of the credit under § 45X, consistent with the well-established federal income tax rules under § 451 and benefits and burdens of ownership test for when tax ownership shifts from seller to buyer.

- The Guidance should confirm that eligible components, the production of which is underway prior to January 1, 2023 (work in progress), qualifies for the § 45X credit, provided those components are completed and sold after December 31, 2022.

- Guidance should clarify that the determination of the "total rated capacity (expressed on a per watt basis)" is at the time of the production and sale of the specified wind energy components, and this standard is not based on project-specific criteria. This determination should be based on the manufacturer's highest rated capacity information for the components produced and sold or on accepted standard industry capacity specifications and ratings.

- Guidance should confirm that corporate affiliates or other related parties of the taxpayer may produce eligible components that are ultimately sold by the taxpayer (or a corporate affiliate or related party of the taxpayer) to an unrelated person. Corporate affiliates and related parties should not be required to actually sell the eligible components within the consolidated group or related party group in order to satisfy the requirements of § 45X and/or § 45X(a)(3), so long as those components are ultimately sold to an unrelated person for end-use or an election under § 45X(a)(3)(B) applies to such sale.

- Guidance should address repowering and allow the credit amount for wind energy components, specifically the nacelle, even if the nacelle contains some used parts, provided the 80/20 Rule under existing IRS guidance is otherwise satisfied. In particular, the Guidance should confirm that the nacelle, which is typically the major component that is repowered in a wind turbine, may contain a re-used fiberglass cover and certain other parts without affecting the ability of the repowered nacelle to receive the full value of the § 45X credit.

Credit Monetization: Transferability. Guidance should address the following points:

- The transferor taxpayer may transfer only a portion of any Eligible Credit. This would include the transferor taxpayer retaining a portion of the Eligible Credit for use against its own income tax liability and transfer the remaining portion.

- The transferor taxpayer may transfer any portion of an Eligible Credit to multiple transferees.

- Guidance should recognize that the transfer of an eligible credit may be made under a single transfer agreement with one or more transferee taxpayers that covers multiple taxable years, consistent with how the credits operate, and including the entire 10- or 12-year credit period. Guidance should confirm that the transferee taxpayer(s) may pay for any such eligible credits to be transferred to them over the credit period on an upfront payment basis combined with annual or periodic payments for excess credits (commonly referred to as "Paygo") in order to address any variability in production and applicable credits over the term of the transfer agreement.

- Guidance should confirm that the partners in a partnership may agree that the partnership can elect to transfer the credits allocable to any partner, in whole or in part. Guidance should provide that the partnership can specially allocate the tax-exempt income from the cash consideration received from a transfer of eligible credits as agreed by the partners and in a manner that is consistent with Treas. Reg. § 1.704-1(b), and that the partners may distribute the cash in any manner agreed upon by the partners in the partnership agreement. To the extent that such a partnership otherwise satisfies the requirements of Rev. Proc. 2007-65, Guidance should clarify that the above transfer of credits and special allocations are consistent with the safe harbor provided by the revenue procedure.

- Guidance should provide a single project election under which a taxpayer with multiple facilities, such as a windfarm, can elect to sell/transfer all or a portion of the total PTCs generated for such single project in a taxable year.

- The Guidance should confirm that PTCs allowable for taxable years beginning after December 31, 2022, are permitted to be transferred, even if the facility to which they relate was placed in service prior to the January 1, 2023 effective date of § 6418.

- The application of the basis reduction and recapture rules is not clear under § 6418(g)(3). Importantly, the Guidance should clarify whether the increase in tax required under § 50(a)(1) is to be made with respect to the transferor taxpayer or the transferee taxpayer(s) and explain the interplay between the corresponding basis reductions or increases with the applicable recapture amount.

- Guidance should adopt flexible procedures for taxpayers to supply information necessary to verify the transfer of eligible credits and to prevent errors and abuse. Those procedures should be limited to information returns and/or registration as Congress has suggested in the statute. The Guidance should not impose any preliminary or pre-transfer audit or review process that impedes the ability of taxpayers to transfer eligible credits on a timely and efficient basis and for transferee taxpayers to claim the eligible credits on their tax returns.

- Guidance should provide specific procedures for the examination of an eligible credit and the determination of any excessive credit transfer, including the application of the procedures under subtitle F of the Code and the assessment and collection of any excessive credit transfer and penalty amount.

- Guidance should clarify which party (transferor taxpayer, transferee taxpayer, or both taxpayers) and which item (credit, return, or both) are subject to examination by the IRS or other agency.

- Guidance should confirm that deficiency procedures (subchapter B of chapter 63 of the Code) apply to any determination of an excessive credit transfer, including with respect to the amount of the excessive credit transfer and the 20% penalty amount. The Guidance should provide all of the normal rights of the transferor taxpayer or transferee taxpayer to challenge and appeal any adjustment to an eligible credit or deficiency in tax.

- Guidance should clarify that only one tax deficiency and penalty may be determined with respect to the same eligible credit – i.e., no "stacking" of tax and penalties.

- Guidance should define the term "reasonable cause" consistent with other contexts under the Code in which this term is used in waiving penalties (e.g., § 6664).

- Guidance should confirm and clarify the application of the transfer provisions under § 6418 to estimated tax payment obligations by specifically allowing taxpayers to offset their quarterly estimated taxes with transferred credits (without penalty under § 6655).

Credit Monetization: Direct Pay. Taxable entities may elect direct pay with respect to the § 45V credit, the § 45Q credit, and the § 45X credit. Special rules are provided for partnerships owning these types of facilities. Guidance should address the following points:

- Guidance should clarify, regardless of the 5-year period in § 6417(d)(1)(D)(ii), that the taxpayer is entitled to make the direct payment election on a facility-by-facility basis with respect to the § 45X credit—in particular, with respect to any new manufacturing facilities brought online in response to the Congressional mandate under § 45X.

- Guidance should adopt flexible procedures for taxpayers to supply information necessary to verify the payment amount and to prevent errors and abuse. Procedures should be limited to information supplied with the taxpayer's tax return or registration as Congress has suggested in the statute.

- Guidance should clarify that any Credits may be applied as a reduction to any quarterly estimated tax payments (without penalty) and to offset any taxes that are reported on the taxpayer's income tax return for any taxable year in which a payment election is in effect. Any Credits in excess of the taxpayer's taxes (after other credits and payments to tax are accounted for) should be refunded to the taxpayer similar to excess estimated tax payments or refundable credits.

- Guidance should not impose any preliminary pre-payment audit or review process that impedes the ability of taxpayers to receive their payment for incentivized production under § 45X, § 45V, or § 45Q on a timely and efficient basis.

- Guidance should apply the procedures under subtitle F of the Code to direct payments. In particular, taxpayers should be entitled to overpayment interest from the date prescribed under § 6417(d)(4)(B), in the case of any delay and consistent with the overpayment procedures under § 6611. In addition, the current process for tax refunds is lengthy, and does not create the type of certainty and timing needed to make these large investments. To ensure that our existing tax processes do not unintentionally create disincentives to proceed, we welcome the opportunity to work with the Administration and other stakeholders on an expedited process for direct pay refunds.

* * * *

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Briefing Paper
Comments in Response to Notice 2022-47
Section 45X Advanced Manufacturing Production Credit
Wind Energy Components

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Briefing Paper
Comments in Response to Notice 2022-47
Section 45X Advanced Manufacturing Production Credit
Wind Energy Components

November 4, 2022

The Inflation Reduction Act of 2022, Pub. L. No. 117-169 ("IRA"), provides tax credits for production and sale of specified wind energy components, including a blade, nacelle, tower, offshore wind foundations, and related offshore wind vessels under § 45X of the Internal Revenue Code ("Code").[1] Section 45X also applies to other eligible components, including solar energy components, inverters, qualifying battery components, and applicable critical minerals, although this paper focuses on wind energy components. Taxpayers require guidance on the application of § 45X to wind energy components, including with respect to (i) the meaning of the terms "produced" and "production," (ii) the meaning of the term "sale" for purposes of the timing of the § 45X credit, (iii) the determination of the "total rated capacity" of the wind turbine for purposes of calculating the credit amounts for wind energy components, (iv) recognition that wind energy components may be produced by affiliates of a manufacturer and sold to unrelated persons, and (v) the application of § 45X to a repowered wind energy facility (these issues are described together as the "Guidance").

Background

The § 45X credit for any taxable year is an amount equal to the sum of the credit amounts determined under § 45X(b) with respect to each eligible component (as defined in § 45X(c)) produced by the taxpayer and sold by the taxpayer to an unrelated person. Under § 45X(c)(1), the term "eligible component" is defined to include "any wind energy component." The term "wind energy component" means any blades, nacelles, towers, offshore wind foundations, and related offshore wind vessels, § 45X(c)(4)(A), which are defined in § 45X(c)(4)(B) as follows:

> *Blade*. An airfoil-shaped blade which is responsible for converting wind energy to low-speed rotational energy.
>
> *Nacelle*. The assembly of the drivetrain and other tower-top components of a wind turbine (with the exception of the blades and the hub) within their cover housing.
>
> *Tower*. A tubular or lattice structure which supports the nacelle and rotor of a wind turbine.
>
> *Offshore wind foundation*. The component (including transition piece) which secures an offshore wind tower and any above-water turbine components to the seafloor using—(I)

[1] All Section (§) references are to the Code as amended by the Inflation Reduction Act of 2022, Pub. L. No. 117-169.

fixed platforms, such as offshore wind monopiles, jackets, or gravity-based foundations, or (II) floating platforms and associated mooring systems.

Related offshore wind vessel. Any vessel which is purpose-built or retrofitted for purposes of the development, transport, installation, operation, or maintenance of offshore wind energy components.

Section 45X(b) sets forth the credit amounts for each eligible component, including the wind energy components above. In the case of a related offshore wind vessel, the credit amount is equal to 10% of the sales price of such vessel. § 45X(b)(1)(F)(i). With respect to other wind energy components, the credit amount is equal to the product of the "applicable amount" with respect to such component, multiplied by the total rated capacity (expressed on a per watt basis) of the completed wind turbine for which such component is designed. § 45X(b)(1)(F)(ii). Under § 45X(b)(2)(A), the "applicable amount" for each wind energy component is listed below:

(i) in the case of a blade, 2 cents;
(ii) in the case of a nacelle, 5 cents;
(iii) in the case of a tower, 3 cents; and
(iv) in the case of an offshore wind foundation—
  (I) which uses a fixed platform, 2 cents, or
  (II) which uses a floating platform, 4 cents.

These amounts are subject to phaseout rules set forth in § 45X(b)(3)(B) with phaseout percentages of 75% for sales in 2030, 50% for 2031, 25% for 2032, and full phaseout for sales after 2032.

Section 45X(d)(1) provides that persons are treated as related to each other if such persons would be treated as a single employer under the regulations prescribed under the common control rules of § 52(b). Section 45X(a)(3)(A) provides a special rule that, for purposes of § 45X(a), treats a taxpayer as selling components to an unrelated person if such component is sold to such person by a person related to the taxpayer. Section 45X(a)(3)(B)(i) provides that "[a]t the election of the taxpayer (in such form and manner as the Secretary may prescribe), a sale of components by such taxpayer to a related person shall be deemed to have been made to an unrelated person." For this purpose, § 45X(a)(3)(B)(ii) provides that "[a]s a condition of, and prior to, any election described in clause (i), the Secretary may require such information or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, or any improper or excessive amount determined under [§ 45X(a)(1)]."

Section 45X(d)(2) provides that sales of eligible components are taken into account under § 45X *only* with respect to eligible components the production of which is *within the United States or a U.S. possession*.

Discussion

A. <u>Meaning of the Terms "Produced" and "Production"</u>. Under § 45X(d)(2), sales are taken into account *only* with respect to eligible components the "production" of which is within the United States (or a possession of the United States). The statute does not otherwise describe how "production" within the United States is determined. It is critical that the terms "produced" and "production" used in § 45X be interpreted in a manner that is consistent with the legislative purpose of incentivizing *domestic advanced manufacturing*. Importantly, the terms "produced" and "production" should be interpreted in a manner that ensures that wind energy components, and other eligible components under § 45X, be subjected to sufficient manufacturing processes, at the eligible component level, and that parties are not permitted to take advantage of the credit by making insignificant investments in "manufacturing light" facilities that do not involve sufficient U.S. manufacturing.

The Guidance should define the terms "produced" and "production" in a manner that is consistent with the legislative purpose of incentivizing domestic manufacturing. Specifically, the term "produced in the United States" is defined elsewhere in the IRA, in the domestic content bonus provisions (§§ 45(b)(9)(B), 45Y(g)(11)(B)), by reference to the Buy America Act ("BAA") regulations. The BAA regulations, together with the substantial body of guidance issued by the Federal Transit Administration ("FTA") in administering those regulations, require significant alteration and transformation of subcomponents in order to form a new component (or product). The BAA regulations and guidance preclude mere assembly and other forms of light manufacturing from qualifying as sufficient manufacturing processes. The BAA regulations and guidance provide a clear set of rules for promoting domestic manufacturing and deterring the use of "manufacturing light" activities to improperly access tax credits. A comprehensive explanation of those regulations and citations to applicable authorities under the guidance is provided in the GE Briefing Paper on the Domestic Content Bonus.

It is important to emphasize here that the terms "produced" and "production" should be read to be consistent with the term "produced in the United States" as defined in the domestic content bonus provisions (§§ 45(b)(9)(B), 45Y(g)(11)(B)), by reference to the BAA regulations with regard to a manufacturing process and manufactured product. Thus, the term "produce" should mean manufacturing – consistent with the statutory purpose of incentivizing domestic advanced manufacturing and how the term is applied for the domestic content bonus credit. The Guidance should distinguish between the manufacturing of eligible wind energy components – for example, in a manufacturing facility – from the installation of wind energy components at the relevant project site. Installation and other onsite construction activities at the project site do not constitute manufacturing or production of eligible components. For example, installing foreign-sourced subcomponents into a nacelle or other eligible component at the project site, as part of the standard installation and assembly process, should not result in the nacelle being treated as produced within the United States.

As explained in the GE Briefing Paper on the Domestic Content Bonus, under the BAA rules, onsite construction activities generally do not constitute manufacturing processes for purposes of the BAA rules. Under the BAA regulations, "[a] *component may be manufactured at the final assembly location* [i.e., the project construction site] *if the manufacturing process to produce the component is an activity separate and distinct from the final assembly of the end*

product." 49 CFR 661.11(d) (emphasis added). Onsite installation and construction activities involving subcomponents of the wind energy components are not *activities separate and distinct* from the final assembly of the wind turbines at the project site, even if they involve some level of welding, connecting, and testing. This notion of "onsite manufacturing," which is nothing more than a part of the regular installation process for the project, should not be permitted by the Guidance to be used to avoid the requirement in § 45X(d)(2) that eligible components be produced within the United States.[2] On the other hand, where the nacelle, including the drivetrain, the machine head parts and elements, the main shaft, the main bearing, the yaw bearing, bedplate, gearbox, and similar items incorporated within the nacelle undergo a manufacturing process in the United States and is shipped to the project site as a single unit, the installation at the site of a limited number of subcomponents as part of the normal installation process should not prevent the nacelle from being treated as produced in the United States.

Requested Guidance: The Guidance should confirm the definition of "produced" and the application of § 45X(d)(2) with respect to "production" within the United States:

- Guidance should define the use of the terms "produced" and "production" in § 45X in a manner consistent with the BAA regulations and related guidance, as they likewise should be applied to the domestic content bonus credit provisions. The Guidance should adopt the definition of the term "manufacturing process" set forth in 49 C.F.R. 661.3, incorporating the BAA guidance applying this definition, for purposes of defining the terms "produced" and "production" in § 45X and applying the requirement in § 45X(d)(2) that production of eligible components occur within the United States or a United States possession. Consistent with the rules for determining domestic content, manufacturing and produced should be interpreted to mean "the application of processes to alter the form or function of materials or of elements of the product in a manner adding value and transforming those materials or elements so that they represent a new end product functionally different from that which would result from mere assembly of the elements or materials."

- Guidance should confirm, consistent with 49 CFR 661.5(d)(2), that the origin of the subcomponents of an eligible component for the § 45X credit is disregarded; provided, however, that there are sufficient manufacturing processes that occur at the component level within the United States. Guidance should adopt standards similar to those used by the FTA in its rulemaking and guidance for determining whether there has been sufficient manufacturing processes at the component level versus mere assembly.

- Guidance should adopt appropriate protections with respect to so-called "onsite manufacturing." Foreign subcomponents should not cause the wind energy components in which they are incorporated to be treated as produced within the United States where a significant number of the subcomponents are incorporated as part of installation or other construction activities at the project site. Onsite manufacturing should only be permitted,

[2] It is also worth noting that the § 45X credit is based on the timing of the sale of the eligible component by the manufacturer. The notion of "onsite manufacturing," which involves installation and construction activities, makes the timing and calculation of the credit unclear. Again, onsite manufacturing creates significant issues in the application and administration of the § 45X credit and should not be permitted by the Guidance.

consistent with the BAA rules, where the manufacturing activities are separate and distinct from the installation and construction of the wind energy components at the project site.

B. Meaning of the Terms "Sale" and "Sold". In order to qualify for the § 45X credit, each eligible component must be produced by the taxpayer, and during the relevant taxable year, *sold* by such taxpayer to an unrelated person. § 45X(a)(1). Under § 45X, the timing of the credit is determined on the basis of when the eligible component is "sold" – i.e., the § 45X credit is allowable within the taxable year in which the "sale" occurs.

The terms "sale" and "sold" have an established meaning in the tax law, and they should be interpreted consistently in the context of the § 45X credit. Specifically, these terms should be interpreted consistent with the rules under § 451 for determining the timing of income inclusion under the accrual method of accounting. Under those rules, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (the "all events test"). Treas. Reg. § 1.451-1(a). Under the all events test, the U.S. Tax Court has explained the timing of the sale as follows:

> At what point in time a sale takes place is to be determined from the totality of the circumstances. While no single factor is controlling, passage of title is perhaps the most significant factor to be considered, although the transfer of possession is also significant. *Commissioner v. Segall*, 114 F.2d 706, 709-710 (6th Cir. 1940), *cert. denied* 313 U.S. 562 (1941). The objective is to determine at what point in time the seller acquired an unconditional right to receive payment under the contract. *Lucas v. North Texas Lumber*, 281 U.S. 11, 13 (1930).

Hallmark Cards, Inc. v. Comm'r, 90 T.C. 26, 32 (1988). In general, the tax authorities apply the "benefits and burdens of ownership" test to analyze when the above events occur. Thus, a "sale" occurs and is effective when there has been a present transfer of the benefits and burdens of ownership and all conditions precedent to the transfer of ownership have been satisfied. *Hammerstrom v. Comm'r*, 60 T.C. 167, 183 (1997); Rev. Rul. 69-93, 1969-1 CB 139. These principles are well-established and understood by taxpayers and tax practitioners in the context of tax ownership issues. They should be applied in a similar manner here to determine when the "sale" has occurred for § 45X purposes and the taxable year in which the credit is allowable.

An additional item requires discussion here. The effective date for § 45X provides that the credit applies to "components produced and sold after December 31, 2022." IRA § 13502(c). This language raises a question whether eligible components currently in production, but which are completed and sold after December 31, 2022, qualify for the § 45X credit. During the consideration of the Senate Amendment for the IRA, Senator Warner addressed a specific question on this issue to Chairman of the Senate Finance Committee, Senator Wyden, during a colloquy on the Senate floor:

> Mr. WARNER. Mr. President, I ask unanimous consent to engage in a colloquy with Senator WYDEN for clarification regarding a tax provision included in the bill currently before the Senate.

> With regard to the advanced manufacturing tax credit, it is the intention that section 45X, as established by section 13502 of the Inflation Reduction Act, is intended to apply to components for which production was completed after December 31, 2022, and are sold to an unrelated party after December 31, 2022?
>
> In other words, the credit should be available to the entirety of eligible components currently underway if those components are concluded after 2022. For example, an offshore wind vessel that began construction in 2019 and was completed at a date after December 31, 2022, would be eligible for the credit applied to the full cost of production of the vessel and not just for the portion completed after December 31, 2022.
>
> Mr. WYDEN. I thank the Senator for his inquiry. That is correct. The credit is intended for any eligible components produced and sold after December 31, 2022, regardless of the portion of the component that was produced before January 1, 2023.

Cong. Rec. Sen. at S4166 (Aug. 6, 2022). In the absence of reports from the relevant tax-writing committees, the colloquy above should be accorded weight and reflective of congressional intent and considered to be part of the legislative history to the IRA. Thus, taxpayers should be entitled to claim the full credit amounts for eligible components that are in the process of being produced but not yet completed in 2022, and which are later completed and sold after December 31, 2022.

Requested Guidance: The Guidance should define the terms "sale" and "sold," for the purpose of determining the timing of the credit under § 45X, consistent with the well-established federal income tax rules under § 451 and the benefits and burdens of ownership to determine when tax ownership shifts from seller to buyer. The Guidance should confirm that eligible components, the production of which is underway prior to January 1, 2023 (work in progress), qualifies for the § 45X credit, provided those components are completed and sold after December 31, 2022.

C. Determination of Total Rated Capacity. Under § 45X(b)(1)(F), the credit amount for wind energy components (other than related offshore wind vessels) is determined based on the "total rated capacity (expressed on a per watt basis) of the completed wind turbine for which such component is designed." The credit amount for each individual component is this capacity multiplied by the "applicable amount" (expressed in specific cents) listed per component in § 45X(b)(2)(A). Section 45X does not provide any guidance on how the term "total rated capacity (expressed on a per watt basis)" is determined across varying components and technologies.

Notice 2022-47, sec. 3.01(5)(a), 2022-43 IRB 312, inquires whether additional clarification is needed regarding the definitions of an "eligible component" in § 45X, and how the amount of the § 45X credit should be calculated for components that could be used in systems of varying capacities.

The calculation of the credit amounts for wind energy components requires clarification. Unlike other types of eligible components, § 45X(b)(1)(F) refers to the total rated capacity of the completed wind turbine but does not address the capacity of the individual components to which the § 45X credit is applicable. In drafting § 45X in this manner, with respect to wind energy components, it is not apparent that Congress intended a different treatment for wind energy components than other technologies (such as solar) that are rated on a component basis at the

time they are sold. Importantly, the capacity of a wind energy component may be different after production of the component is completed and at the time it is sold under § 45X than when it is actually installed at the project site in a particular qualified facility or energy project. The statutory reference to the "completed wind turbine" could be read to require the manufacturer of individual components to address varying capacities for the completed wind turbines at particular project sites. This type of analysis could not have been the intent of Congress. A manufacturer of individual wind energy components may not have access to this information and does not control the selection of particular project sites or installation which may cause capacities to vary. Guidance should clarify that the determination of the "total rated capacity (expressed on a per watt basis)" is at the time of the production and sale of the specified wind energy components, and this standard is not based on project-specific criteria. This determination should be based on the manufacturer's maximum nameplate rated capacity information for the components produced and sold, or on accepted standard industry capacity specifications and ratings. The nameplate capacity, or rated capacity, of a wind turbine is its maximum output rating, or how much power it can produce when operating at full capacity.[3]

Notice 2022-47, sec. 3.01(5)(b), also inquires how verification of the applicable credit amount should be demonstrated. Any verification of the § 45X credit amounts should be made on the applicable form (or portion thereof) prescribed by the IRS for reporting the credit (e.g., similar to Form 8835, Renewable Electricity, Refined Coal, and Indian Coal Production Credit, used for other production tax credits ("PTCs")). For example, we would expect that the form would be broken down by each eligible component with the statutory credit amount for each component and the taxpayer's input of the total rated capacity for that component on an aggregate basis. Guidance should provide that the taxpayer maintain appropriate books and records to verify the production and sale of the eligible components, as well as their place of origin, in order to verify that the credit amounts have been properly reported. No further verification of the credit amount is required under § 45X prior to claiming the credit.

Requested Guidance: The Guidance should clarify the application of § 45X(b)(1)(F) to wind energy components. Specifically, the Guidance should clarify that the determination of the "total rated capacity (expressed on a per watt basis)" is at the time of the production and sale of the specified wind energy components, and this standard is not based on project-specific criteria. This determination should be based on the manufacturer's maximum nameplate rated capacity information for the components produced and sold or on accepted standard industry capacity specifications and ratings.

D. Intercompany Production and Sales. Under § 45X(a)(1), the eligible component must be both *produced by the taxpayer* and *sold by such taxpayer* to an unrelated person. This language is consistent with other PTCs and raises an issue regarding whether the taxpayer is both the "producer" and "seller" of eligible components where the taxpayer is a member of a consolidated corporate group and where the taxpayer has affiliated or related companies that may be engaged in elements of the manufacturing process. For example, in some cases, a corporate

[3] https://www.energy.gov/eere/wind/articles/top-trends-wind-technology#:~:text=The%20nameplate%20capacity%2C%20or%20rated,when%20operating%20at%20full%20capacity.

affiliate of the taxpayer may produce one or more of the eligible components that are subsequently sold by the taxpayer or a different affiliate of the taxpayer to an unrelated person.

Pursuant to § 45X(a)(3)(A), a taxpayer is treated as selling components to an unrelated person if such component is sold to such person by a person related to the taxpayer. This provision is consistent with IRS guidance with respect to other PTCs. For example, the IRS has recognized that a corporation which is a member of an affiliated group filing a consolidated return is treated as selling the applicable product to an unrelated person if the product is sold to an unrelated person by another member of the affiliated group. *See, e.g.*, Notice 2010-54, sec. 3.06, 2010-40 IRB 404 (production and sale by corporate affiliates); Notice 2008-60, sec. 4, 2008-30 IRB 178 (the requirement of a sale to an unrelated person will be treated as satisfied if the producer sells electricity produced from open-loop biomass to a related person for resale by the related person to a person that is not related to the producer). Thus, if one subsidiary of the taxpayer produces an eligible component (or is otherwise engaged in some element of the production process for that component) and either the taxpayer or a separate subsidiary (or other corporate affiliate) is the party that actually sells the component to an unrelated person, § 45X(a)(3)(A) should apply to allow the § 45X credit with respect to the production and sale of the eligible component. The Guidance should clarify and recognize the ability to use different affiliated companies of a consolidated group or related parties to conduct elements of the production and sale of eligible components under § 45X – similar to the guidance previously provided by the IRS in Notices 2010-54 and 2008-60, as well as similar prior guidance for renewable energy facilities.

Guidance should also address how the election under § 45X(a)(3)(B)(i) applies. Certain manufacturers may also engage in development or other construction activity through an affiliate or other related entity with respect to the eligible components it produces. In such cases, it is appropriate for a sale of the eligible component to the affiliate or related entity to be treated as a sale to an unrelated person consistent with § 45X(a)(3)(B). For this purpose, § 45X(a)(3)(B)(ii) provides that "[a]s a condition of, and prior to, any election described in clause (i), the Secretary may require such information or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, or any improper or excessive amount determined under [§ 45X(a)(1)]." Guidance should clarify that the election under § 45X(a)(3)(B)(i) applies, among other situations, to sales to an affiliate or other related entity where such related entity will use, directly or indirectly, the eligible component in a qualified facility or project.

Requested Guidance: The Guidance should confirm that corporate affiliates or other related parties of the taxpayer may produce eligible components that are ultimately sold by the taxpayer (or a corporate affiliate or related party of the taxpayer) to an unrelated person. Corporate affiliates and related parties should not be required to actually sell the eligible components within the consolidated group or related party group in order to satisfy the requirements of § 45X and/or § 45X(a)(3), so long as those components are ultimately sold to an unrelated person for end-use or an election under § 45X(a)(3)(B) applies to such sale.

E. <u>Application of § 45X to a Repowered Wind Facility</u>. The IRS has long ruled that a wind facility that is repowered has a new original placed-in-service date and requalifies for PTCs if the capital cost of the new repowering components equals or exceeds 80% of the sum of

such new capital costs and the fair market value of any old components retained in the repowered wind turbine (i.e., the "80/20 Rule"). Rev. Rul. 94-31, 1994-1 CB 16. The 80/20 Rule is a longstanding administrative position of the IRS dating back at least to the 1960s, and was established specifically with respect to wind facilities under § 45 in Rev. Rul. 94-31. It has been applied to other § 45 facilities, *see* Notice 2008-60, 2008-30 IRB 178 (biomass), and other PTC facilities such as § 45Q, *see* Treas. Reg. § 1.45Q-2(g)(5). This rule was restated and reaffirmed recently in Notice 2016-31, § 6.01, 2016-23 IRB 1025, and in Notice 2017-4; 2017-3 IRB 541, specifically with respect to the repowering of wind turbines. The 80/20 Rule is well-established and longstanding in the context of § 45 and in the tax law generally.

It is important to apply § 45X in a manner that recognizes the importance of the repowering of existing infrastructure and provides flexibility in the utilization of "used property," while still providing appropriate safeguards through the application of the 80/20 Rule. In particular, the Guidance should recognize that the wind industry attempts to reuse certain elements of various components that remain useful in order to avoid waste. Those elements have insignificant value, though they are necessary for the component to function properly.

For example, repowering of wind turbines typically involves the replacement of the drivetrain and other items located within a nacelle. However, the drivetrain and those other items are housed within a protective fiberglass cover that comprises the outside portion of the nacelle. Although this fiberglass cover is necessary for the housing and protection of the internal portions of the nacelle, it has insignificant value relevant to the value of the whole and does not require significant manufacturing. The definition of the term "nacelle" in § 45X(c)(4)(B)(iii) references the term "cover housing." However, the definition describes "the assembly of the drivetrain and other tower-top components of a wind turbine ... within their cover housing." This reference to the cover housing establishes the boundaries of the nacelle component. It should not be read definitionally to preclude its reuse in the context of a repowering of the nacelle. The reuse of the fiberglass cover for the nacelle, as well as certain other items within the nacelle, should not affect the eligibility of the repowered nacelle for the full § 45X credit.

Requested Guidance: Guidance should address repowering and allow the credit amount for wind energy components, specifically the nacelle, even if the nacelle contains some used parts, provided the 80/20 Rule under existing IRS guidance is otherwise satisfied. In particular, the Guidance should confirm that the nacelle, which is typically the major component that is repowered in a wind turbine, may contain a re-used fiberglass cover and certain other parts without affecting the ability of the repowered nacelle to receive the full value of the § 45X credit.

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Briefing Paper
Comments in Response to Notice 2022-50
Section 6417 Elective Payment of Applicable Credits

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Briefing Paper
Comments in Response to Notice 2022-50
Section 6417 Elective Payment of Applicable Credits

November 4, 2022

The Inflation Reduction Act of 2022, Pub. L. No. 117-169 ("IRA"), provides a direct payment election with respect to certain applicable credits under § 6417 of the Internal Revenue Code ("Code").[1] This election generally applies to specified tax-exempt entities, but it is also available to taxable entities (not tax-exempt) for three designated credits—the advanced manufacturing production credit under § 45X ("§ 45X credit"), the carbon oxide sequestration credit under § 45Q ("§ 45Q credit"), and the clean hydrogen production credit under § 45V (the "§ 45V credit," and together with the §§ 45X and 45Q credits, for which direct payment may be claimed by a taxable entity, the "Credits"). Taxpayers require guidance on the application of the payment election with respect to those Credits, including: (i) the operation of the payment election with respect to estimated tax payments and taxes reported on the income tax return, (ii) the time period to which the payment election applies for each of the Credits and the application of the payment election to investments in new facilities, (iii) the administrative process and timing of the payment, (iv) the application of the excessive payment and penalty rules, and (v) application of § 6417 to partnerships (these issues are described together as the "Guidance").

Background

Under § 6417(a), an "applicable entity" may make an election to receive a payment in lieu of credits (as specified in § 6417(b))—"such entity shall be treated as making a payment against [income tax] (for the taxable year with respect to which such credit was determined) equal to the amount of such credit." The term "applicable entity" is defined narrowly to include only tax-exempt entities, § 6417(d)(1)(A), but is also available to taxable entities with respect to the § 45V credit under § 6417(d)(1)(B), the § 45Q credit under § 6417(d)(1)(C), and the § 45X credit under § 6417(d)(1)(D). An election by a taxable entity with respect to a Credit under § 6417(d)(1)(B), (C), or (D) must be made at such time and such manner as the Secretary may provide and may not be made with respect to any taxable year beginning after December 31, 2032. § 6417(d)(1)(E). Special rules are provided for partnerships under § 6417(c).

With respect to the § 45V credit, if a taxable entity makes an election with respect to any taxable year in which such taxpayer has placed in service a qualified clean hydrogen production facility (as defined in § 45V(c)(3)), the taxpayer is treated as an applicable entity for purposes of § 6417 for such taxable year. § 6417(d)(1)(B). In the case of any payment election with respect to the § 45V credit, any election applies separately with respect to each qualified clean hydrogen production facility, must be made for the taxpayer year in which such facility is placed in service (or within the 1-year period subsequent to the date of the enactment of § 45V (Aug. 16, 2022) in

[1] All Section (§) references are to the Code as amended by the Inflation Reduction Act of 2022, Pub. L. No. 117-169.

the case of facilities placed in service before December 31, 2022), and applies to such taxable year and the 4 subsequent taxable years with respect to such facility which end before January 1, 2033. § 6417(d)(3)(D)(i).

With respect to the § 45Q credit, if a taxable entity makes an election with respect to any taxable year in which such taxpayer has, after December 31, 2022, placed in service carbon capture equipment at a qualified facility (as defined in § 45Q(d)), the taxpayer is treated as an applicable entity for purposes of § 6417 for such taxable year. § 6417(d)(1)(C). In the case of any payment election with respect to the § 45Q credit, any election applies separately with respect to the carbon capture equipment originally placed in service by the taxpayer during a taxable year, and applies to the taxable year in which such equipment is placed in service and the 4 subsequent taxable years with respect to such equipment which end before January 1, 2033. § 6417(d)(3)(C)(i).

With respect to the § 45X credit, if a taxable entity makes an election with respect to any taxable year in which such taxpayer has, after December 31, 2022, produced eligible components (as defined in § 45X(c)(1)), the taxpayer is treated as an applicable entity for purposes of § 6417 for such taxable year. § 6417(d)(1)(D). If a taxable entity makes an election with respect to any taxable year, the taxpayer is treated as having made such election for each of the 4 succeeding taxable years ending before January 1, 2033. § 6417(d)(1)(D)(ii)(I).

With respect to each Credit, taxable entities may revoke the application of the payment election with respect to a qualified advanced manufacturing facility, carbon capture equipment, or qualified clean hydrogen production facility, respectively, and such revocation will apply to the taxable year specified in the revocation and each subsequent taxable year within the 5-year period described for each of the Credits. § 6417(d)(1)(D)(ii)(II) (§ 45X credit), (d)(3)(C)(iii) (§ 45Q credit), (d)(3)(D)(iii) (§ 45V credit). No transfer election under § 6418(a) may be made by the taxable entity for any taxable year with respect to eligible components under § 45X, carbon capture equipment under § 45Q, or a qualified clean hydrogen production facility under § 45V, as the case may be, for any taxable year for which a payment election has been made. § 6417(d)(1)(D)(iii) (§ 45X credit), (d)(3)(C)(ii) (§ 45Q credit), (d)(3)(D)(ii) (§ 45V credit).

Any payment election for a Credit must be made not later than the due date (including extensions) for the return for the taxable year for which it is made, § 6417(d)(3)(A)(i)(II), and payment is treated as made on the later of the due date (without regard to extensions) or filing date of the return for the taxable year, § 6417(d)(4)(B). The Secretary may require information or registration as a condition of, and prior to, any amount being treated as a payment under § 6417(a) for purposes of preventing duplication, fraud, improper payments, or excessive payments. § 6417(d)(5). Section 6417(d)(6) provides special rules for an "excessive payment," including repayment of any excessive payment determined by the Secretary and a 20% penalty amount that is subject to a reasonable cause waiver. If a payment election is made, the credit is reduced to zero and is, for any other purposes of the Code, deemed to have been allowed to such entity. § 6417(e).

Discussion

A. Operation of Payment Election. Section 6417(a) provides that in the case of an election by an applicable entity "with respect to any applicable credit determined with respect to such entity," such entity will be treated as making a payment against income tax for the taxable year (with respect to which the applicable credit was determined) "equal to the amount of such credit." Section 6417(d)(4)(B) then provides, in the case of a taxable entity, that the payment is treated as made on the later of the due date (without regard to extensions) of the tax return for the taxable year or the filing date of the return. The statute, however, does not further address the operation of the payment election. Importantly, the statute does not address whether the taxpayer first applies a portion of the credit against its taxes with any portion in excess of its tax liability being refunded to the taxpayer.

If a payment election is made, on the basis of the language in § 6417(a) and § 6417(d)(4)(B), a corporate taxpayer would be treated as making a payment against income taxes on the Form 1120, U.S. Corporation Income Tax Return. The expectation is that this deemed payment would be reported on a new line in Schedule J of the Form 1120, in Part III – Payments and Refundable Credits, and either treated directly as a payment included in "Total payments" or as a refundable credit (the most recent analogue is the AMT refundable tax credit from the Tax Cuts and Jobs Act of 2017). The total payments and credits would then be reported on line 33 (from the 2021 Form 1120 or its equivalent) and then used to calculate the "Amount owed" in line 35 and the "Overpayment," if any, in line 36. Any overpayment would either be creditable against any other outstanding tax liabilities, refundable to the taxpayer, or creditable against estimated taxes for the following taxable year.

Importantly, taxpayers should be able to apply any Credits in making their quarterly estimated tax payments even though the payment is not deemed effective until the later of the due date or filing date of the applicable tax return. Specifically, the taxpayer should be permitted to make the payment election prior to the due date of its quarterly estimated tax payment. Under § 6417(d)(3)(A)(i)(II), in the case of a taxable entity, the taxpayer may make its election not later than the due date (including extensions of time) for the return of tax for the taxable year for which the election is made, but in no event earlier than 180 days after the date of the enactment of § 6417 (i.e., 180 days after Aug. 16, 2022, or Feb. 12, 2023). Accordingly, a calendar-year taxpayer should be permitted to make the payment election in advance of the due date for quarterly estimated tax payments beginning with the first quarter of 2023. In this circumstance, the taxpayer should be permitted to report the direct payment (like a refundable credit) on line 7, Credit for federal tax paid on fuels and other refundable credits, of the Form 1120-W, Estimated Tax for Corporations (or the equivalent line for taxable years after 2022), to reduce its estimated taxes. Alternatively, the taxpayer should be permitted to report the Credit on line 3 (Tax credits) of the Form 1120-W, on a preliminary basis, in order to reduce quarterly estimated tax payments, and then make its payment election and/or claim the direct payment on its Form 1120 or other form prescribed under the Guidance at the time designated under § 6417(d)(4)(B) (i.e., later of the return due date or filing date). The Guidance should address the application of § 6655 and the associated regulations with respect to the timing of the application of the direct payment or Credit against estimated tax obligations so that estimated tax penalties are not inadvertently triggered as a result of any administrative delay in making the direct payment.

Requested Guidance: The Guidance should clarify that any Credits may be applied as a reduction to any quarterly estimated tax payments (without penalty) and to offset any taxes that are reported on the taxpayer's income tax return for any taxable year in which a payment election is in effect. Any Credits in excess of the taxpayer's taxes (after other credits and payments to tax are accounted for) should be refunded to the taxpayer similar to excess estimated tax payments or refundable credits.

B. Time Period of Payment Election/New Facilities. Sections 45V, 45Q, and 45X are the only three credits under the IRA for which taxable entities are eligible to elect a direct payment under § 6417 in lieu of claiming those Credits. In allowing a payment election for those Credits, Congress recognized the need to provide an immediate and recurring cash incentive for clean hydrogen production, carbon oxide sequestration, and domestic manufacturing of eligible energy components with respect to both existing and new facilities. It is critical, therefore, that the Guidance interpret § 6417 in a manner that is consistent with Congressional intent and develop flexible and timely rules for administering the election under § 6417 and making direct payment. The application of § 6417 is unclear and requires clarification in a number of key areas.

First, with respect to the § 45X credit, § 6417(d)(1)(D)(ii)(I) provides that if the taxpayer makes the direct payment election "with respect to any taxable year, such taxpayer shall be treated as having made such election for each of the 4 succeeding taxable years ending before January 1, 2033" – i.e., 5 taxable years. However, the § 45X credit has a longer applicable credit period of 10 years – i.e., through the end of 2032. *See* § 45X(b)(3). Consistently, § 6417(d)(1)(E)(ii) provides that no payment election may be made under § 6417 for the § 45V, 45Q, or 45X credit with respect to any taxable year beginning after December 31, 2032. Whereas the elections for §§ 45Q and 45V under §§ 6417(d)(1)(B) and (C) must be made with respect to the taxable year in which the relevant facility or equipment has been placed in service, the § 45X credit does not include any similar placed-in-service limitation for making the payment election. Although the statute addresses making the election for the § 45X credit and subsequent revocation during the 5-year period, the statute does not expressly prohibit or address whether an election may be made for a subsequent 5-year period consistent with the full 10-year credit period under § 45X. The Guidance should clarify whether the payment election is limited to a single 5-year period, or is available for a subsequent 5-year period (for any taxable year or succeeding taxable years ending before January 1, 2033) with respect to the § 45X credit.

Second, each of the Credits (including the § 45X credit) is a production tax credit ("PTC"). The payment election with respect to the § 45V credit applies on a facility-by-facility basis ("any election under subsection (a) shall ... apply separately with respect to each qualified clean hydrogen production facility"), § 6417(d)(3)(D)(i)(I), and the payment election with respect to the § 45Q credit applies on a facility-by-facility basis ("any election under subsection (a) shall ... apply separately with respect to the carbon capture equipment originally placed in service by the applicable entity during a taxable year"), § 6417(d)(3)(C)(i)(I). Thus, the statute is clear that in both cases, the 5-year election period applies on a facility-by-facility basis. The payment election provisions in § 6417(d)(3), with respect to other PTCs that are available to tax-exempt entities, are applied in a similar manner. *See* § 6417(d)(3)(B)(i) (renewable electricity production credit under § 45), § 6417(d)(3)(E)(i) (clean electricity production credit under §

45Y). The investment tax credits listed in § 6417(b) as "applicable credits" are not addressed in the § 6417(d)(3) payment election provisions; no doubt, because they are earned at a singular point in time, in the taxable year that the applicable facility or property is placed in service. Those credits, too, would be determined on a facility-by-facility, or a property-by-property basis for purposes of the direct payment election – consistent with how the underlying credit operates.

The statute is unclear with respect to the § 45X credit and, specifically, whether it applies on a taxpayer basis or applies on a facility-by-facility basis. There are strong policy reasons why § 6417 should be interpreted in the Guidance to apply to the § 45X credit on a facility-by-facility basis consistent with the other PTCs – importantly, the underlying intent of the IRA and § 45X, specifically, is to create a robust U.S. domestic supply chain that will bring manufacturing of renewable energy components onshore, fuel the development and construction of numerous renewable projects across the country, and create high-paying U.S. jobs. A number of U.S. domestic manufacturers are currently supplying these demands – prior to the enactment of the IRA – and some manufacturers may be planning to build new advanced manufacturing facilities that qualify under § 45X. The direct payment election should be available for the full 5-year period for each new facility that is built and placed in service under § 45X, in addition to any existing manufacturing facility that is currently producing eligible components to meet demand. This interpretation is consistent with the application of the § 6417 payment election to each of the other PTCs (including §§ 45V and 45Q). The same should apply to § 45X.

Importantly, the statute repeats in multiple places that the direct payment election is made with respect to a facility or property. Specifically, § 6417(c)(1) provides that "[i]n the case of any applicable credit determined *with respect to any facility or property* held directly by a partnership or S corporation, any election under subsection (a) shall be made by such partnership or S corporation." (Emphasis added.) Section 6417(c)(2) provides that "[i]n the case of *any facility or property* held directly by a partnership or S corporation, no election by any partner or shareholder shall be allowed under subsection (a) with respect to any applicable credit determined *with respect to such facility or property*." (Emphasis added.) Section 6417(d)(6)(C) provides that "the term 'excessive payment' means, *with respect to a facility or property for which an election is made under this section for any taxable year*, an amount equal to the excess of—(i) the amount treated as a payment which is made by the applicable entity under subsection (a), or the amount of the payment made pursuant to subsection (c), *with respect to such facility or property for such taxable year*, over (ii) the amount of the credit which ... would be otherwise allowable ... under this title *with respect to such facility or property for such taxable year*." (Emphasis added.) The above provisions are applicable to § 45X.

The statute should be read consistently with respect to these provisions and with respect to the credit for production from advanced manufacturing facilities under § 45X. While Congress did not address the § 45X credit in the context of the election provisions under § 6417(d)(3),[2] the application of the § 45X credit should be read *in pari materia* with its companion credits under §§ 45Q and 45V, for taxable entities, and with respect to other credits, generally, for tax-exempt entities, as well as the provisions applicable to partnerships, S

[2] Congress addressed the 5-year period for the § 45X credit in the "applicable entity" provisions in § 6417(d)(1), whereas the 5-year period for its companion provisions (§§ 45V and 45Q) are addressed under the election provisions of § 6417(d)(3).

corporations, and excessive payments. As noted earlier, in addition to consistency among the various applicable credits under the statutory language, there are strong policy reasons for allowing new manufacturing facilities that are placed in service to qualify for direct payment on a facility-by-facility basis. If the statute is applied to the § 45X credit on a taxpayer basis, existing manufacturing companies that are currently ramping up to meet the early demand for advanced domestically manufactured products would be effectively penalized for having existing manufacturing and contributing to American jobs and technology innovation. Limiting the payment election on a taxpayer basis would disincentivize domestic manufacturers from building new manufacturing facilities under § 45X – contrary to Congressional intent. Thus, the Guidance should confirm that the 5-year period applicable to the § 45X credit under § 6417(d)(1)(D)(ii)(I) applies on a facility-by-facility basis, rather than on a taxpayer basis, such that new manufacturing facilities are properly incentivized consistent with Congressional intent.

It is worth emphasizing that unlike the payment provisions applicable to the § 45V credit and the § 45Q credit, the § 45X payment provisions in § 6417(d)(1)(D) do not impose any placed-in-service date as a starting point for the § 45X credit or for the payment election – as § 6417 does for the §§ 45V and 45Q credits under § 6417(d). Thus, existing U.S. manufacturing facilities that produce eligible components under § 45X qualify for direct payment regardless of when they were placed in service. Although new manufacturing facilities under § 45X should be eligible for a full 5-year credit period, the Guidance should not impose any placed-in-service date limitation with respect to the § 45X credit or payment election for such credit.

In addition, the Guidance should clarify that existing manufacturing facilities, which do not currently manufacture eligible components, but that are repurposed to support manufacturing of eligible components, should be eligible for a full 5-year payment period for the § 45X credit under § 6417. Similarly, if existing manufacturing facilities (whether currently producing eligible components or not) are expanded to add new, identifiable production lines that increase capacity, the Guidance should clarify whether the new production line is eligible for a separate 5-year payment period for the § 45X credit under § 6417. In these circumstances, with respect to the latter situation, it would be appropriate for the Guidance to impose an anti-abuse provision in the case of a taxpayer that attempts to shift production in order to maximize its § 45X credits versus situations in which the new manufacturing line uses new technology or is used to legitimately expand overall capacity – exactly as Congress intended.

Requested Guidance: Guidance should confirm and/or clarify the following matters with respect to the applicable period for the direct payment election:

- Guidance should confirm whether the direct payment election is limited to a single 5-year period with respect to the § 45X credit or otherwise is available for a second 5-year period for any taxable years ending before January 1, 2033.

- Guidance should clarify, regardless of the 5-year period in § 6417(d)(1)(D)(ii), that the taxpayer is entitled to make the direct payment election on a facility-by-facility basis with respect to the § 45X credit—in particular, with respect to any new manufacturing facilities brought online in response to the Congressional mandate under § 45X, with

respect to existing manufacturing facilities that are repurposed, and with respect to new production lines that expand manufacturing capacity and production.

C. Administrative Process/Timing of Payment. Section 6417(d)(5) provides: "As a condition of, and prior to, any amount being treated as a payment which is made by an applicable entity under subsection (a), the Secretary *may* require such information or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments under this section." (Emphasis added.) It is important that the Guidance address the concerns set forth by Congress in § 6417(d)(5) and adopt sensible procedures that prevent abuse that would undermine the statutory goals of the IRA. We fully support such procedures. At the same time, as noted earlier, it is important that taxpayers receive their direct payments for the taxable year in which the Credits are earned on a timely basis. For example, in the case of § 45X advanced manufacturing, a number of taxpayers have responded to this credit and the other credits under the IRA by accelerating production to keep up with demand for energy components and by announcing substantial investments in new manufacturing facilities. New investments in clean hydrogen production facilities under § 45V and carbon capture equipment under § 45Q are also being contemplated in response to the IRA. The timeliness of the direct payment is essential to achieving successful development of additional production and new investments in applicable facilities and property. In this regard, it is important that the Secretary exercise the discretion provided by Congress in § 6417(d)(5) with this objective in mind and not impose an unnecessary review process that may delay payments and create uncertainty for manufacturers and investors in qualifying facilities and property.

As Congress has suggested, the concerns expressed in the statute may be addressed with information provided by the taxpayer with its tax return (e.g., a prescribed form with information schedules) or a registration process. If registration is required, it may be accomplished by the registration of the taxpayer through the Data Universal Numbering System (DUNS) and/or System for Awards Management (SAM), which has been used in other federal programs. With respect to the Credits, the information necessary to address Congress' stated concerns should be relatively simple and straight-forward, allowing the IRS to immediately identify and to address errors, abuse, duplication of credits, and fraudulent payments.

The Guidance should not implement a preliminary review or audit process by the IRS or any other agency, as a condition of, or prior to, making any direct payment. This type of process would have a detrimental effect on the rapid infusion of capital into renewable energy projects, including advanced manufacturing production under § 45X, qualifying clean hydrogen production facilities under § 45V, and carbon capture equipment under § 45Q. If some form of preliminary review process is deemed necessary by the Secretary, then this review process should be handled on a "first look" basis only to verify that all legal requirements have been satisfied, that the taxpayer is an applicable entity, that the credit claimed is an applicable credit, that the credit amounts have been calculated correctly, and that there is no evident disqualifying factor, improper payment, or excessive payment with respect to the applicable facility, property, or eligible component. Factual issues, if any, should be addressed in a manner consistent with regular IRS examination selection and procedures. The direct payment election should not be a factor, in and of itself, for selection for examination. In any event, any "first look" or other administrative review process should be limited in nature consistent with Congressional intent and should be conducted in a timely manner in advance of any tax return filings by the taxpayer.

Along those lines, it is appropriate to consider the prior discussion of the operation of the payment election. The overriding goal of the payment election, in the case of the Credits, is to get capital into the hands of eligible taxpayers so that U.S. domestic manufacturing capacity can be expanded and critical clean hydrogen production facilities and carbon capture equipment may be deployed. If the payment is deemed to be a payment against income taxes, as § 6417(a) indicates, then the deemed payment should be treated like estimated tax payments or refundable credits that are refunded to the taxpayer as part of the tax return filing process. In this respect, we note that Treas. Reg. § 301.6402-4 addresses payments in excess of amounts shown on the tax return (for example, excessive estimated income tax payments or excessive withholding). In those circumstances, the IRS may credit or refund such overpayment without awaiting the examination of the completed return and without awaiting the filing of a claim for refund.

In the event that the Guidance deems it necessary to conduct some form of limited review of the direct payment (such as the limited "first look" review described above), there is support for a limited examination under § 6425, which provides a mechanism to receive a quick refund of an overpayment of estimated taxes paid by a corporation. Under this provision, the corporate taxpayer may file an application with the IRS after the close of the relevant taxable year, and on or before the 15th day of the fourth month after the close of the taxable year, and before the tax return filing date. *See* § 6425(a)(1).[3] Section 6425(b)(1) provides for a limited examination by the IRS of the application to discover omissions and errors therein and may disallow, without further action, any application which it finds contains material omissions or errors which cannot be corrected within the 45-day review period described in this provision. Alternatively, the IRS also has adopted "limited review" procedures in the context of § 6411 with respect to an application for a tentative carryback refund.[4] Under § 6411(b), the IRS has 90 days to process an application and to issue the refund. Like § 6425, the IRS's review process involves a limited examination to discovery any omissions and errors and to disallow, without further action, any application that it finds has any errors of computation which cannot be corrected within the 90-day period or if it contains any material omissions. *See* Treas. Reg. § 1.6411-3(b) (examination and adjustment) and (c) (disallowance). In applying the above procedures, the IRS has the opportunity to conduct a more thorough examination after the payment has been made to the taxpayer – without losing any of the IRS's rights to make sure any Credits have been properly reported by the taxpayer and the taxpayer is entitled to the direct payment. In any event, consistent with Congressional intent, the Guidance should make every effort to deliver timely payments to taxpayers who qualify for the Credits.

Under § 6417(a), a taxable entity is treated as having made a payment against its income taxes as of the later of the due date (without extensions) of the tax return for the taxable year or the date the tax return is actually filed. § 6417(d)(4)(B). Insofar as § 6417 treats an elective payment as an income tax payment, and deems it to be made as of the specific return dates noted, the provisions of subtitle F of the Code should apply to the deemed payment in the same manner as if an actual payment of tax had been made with the applicable tax return. As noted earlier, the payment should be applied against any taxes due on the return with the remaining portion either refunded to the taxpayer or applied against estimated taxes for the subsequent taxable year. If

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[3] This application is filed on Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax.

[4] This application is filed on Form 1139, Corporation Application for Tentative Refund.

there is any delay in the payment to the taxpayer, beyond the designated tax payment date set forth in § 6417(d)(4)(B), then the overpayment rules of § 6611 should apply and overpayment interest at the rate described in § 6621 should apply from such date.

Requested Guidance: The Guidance should confirm and/or clarify the following matters with respect to the administrative process and timing of the direct payment under § 6417:

- Guidance should adopt flexible procedures for taxpayers to supply information necessary to verify the payment amount and to prevent errors and abuse. Procedures should be limited to information supplied with the taxpayer's tax return or registration as Congress has suggested in the statute.

- Guidance should not impose any preliminary review or audit process that impedes the ability of taxpayers to receive their payment for incentivized production under § 45X, § 45V, or § 45Q on a timely and efficient basis. Any review process should follow similar limited examination procedures administered by the IRS such as the refund procedures for excessive estimated tax payment and tentative carryback refund applications.

- Guidance should apply the procedures under subtitle F of the Code to direct payments (i.e., refundable tax credits). In particular, taxpayers should be entitled to overpayment interest from the date prescribed under § 6417(d)(4)(B), in the case of any delay and consistent with the overpayment procedures under § 6611.

D. Excessive Payment/Penalty Procedures. Section 6417(d)(6) provides rules relating to an excessive payment, which is defined generally as the excess of the amount of the direct payment over the amount of the credit allowable for any taxable year with respect to a facility or property for which an election is made under § 6417. Section 6417(d)(6) describes a process whereby the Secretary makes a determination of an excessive payment, which may result in an increase in the tax imposed on the taxpayer equal to the sum of the amount of the excessive payment and an amount equal to 20% of this payment. This 20% penalty may be waived if it is determined that the excessive payment resulted from reasonable cause. § 6417(d)(6)(B). The statute provides no further guidance regarding the determination of the excessive payment. Importantly, the statute does not address the procedures applicable to this determination and the conduct of any review or examination by the IRS or other agency. These matters should be clarified in the Guidance.

For example, § 6417(d)(6)(A) states only that the taxpayer's income tax is increased but does not address the assessment and collection of this tax. Other provisions in the Code and the IRA, such as the penalty for prevailing wages in § 45(b)(7)(B), include a specific reference to deficiency procedures and state that those procedures do not apply. *See* § 45(b)(7)(B)(ii). On the other hand, § 6417(d)(6)(A) says nothing about deficiency procedures. Those procedures should apply in the case of an excessive payment under § 6417. The taxpayer making a payment election should have the same right to challenge and appeal any adverse determination by the IRS or other agency as taxpayers generally have the right to do. The taxpayer should have the right to appeal any determination of an excessive payment to the IRS Independent Office of

Appeals and deficiency procedures should apply to any determination of an excessive payment – allowing the taxpayer to petition the U.S. Tax Court.

Further, § 6417(d)(6)(A) states that "the tax imposed on such [applicable] entity ... for the taxable year in which such determination is made shall be increased by an amount ...." This language requires clarification. Specifically, the term "taxable year" should be clarified to mean the taxable year in which the applicable credit (i.e., the § 45X credit, the § 45V credit, or the § 45Q credit) was allowable, and not to some later period in which the determination is made. That is, any excessive payment amount should be addressed in the same manner as a tax deficiency under the Code, wherein the tax is assessed for the taxable year to which the deficiency relates (i.e., the taxable year in which the direct payment was elected). Only one deficiency should be determined, *see* § 6212(c) (restricting deficiencies to one notice of deficiency), and there should be no "stacking" of deficiencies, taxes, penalties, or audits with respect to the same Credit. The statutory language requires clarification through Guidance.

Finally, § 6417(d)(6)(B) does not define the term "reasonable cause." In particular, § 6664 includes a reasonable cause exception to accuracy-related penalties otherwise applicable to income tax underpayments under § 6662. Numerous tax cases and other authorities have applied this exception and the factors for establishing reasonable cause under § 6664 are relatively well-established. Treas. Reg. § 1.6664-4(b) describes the facts and circumstances that are taken into account to establish reasonable cause, stating generally:

> The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. ... Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer.

The regulation continues with specific examples and circumstances. Treas. Reg. § 1.6664-4(c) addresses whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the taxpayer's treatment of tax items.

Requested Guidance: Guidance should confirm and/or clarify the following matters with respect to the determination of an excessive payment and the 20% penalty amount:

- Guidance should provide specific procedures for the examination of any direct payment election and any determination of an excessive payment, including the application of the procedures under subtitle F of the Code and the assessment and collection of any excessive payment and penalty amount.

- Guidance should specify that deficiency procedures (subchapter B of chapter 63 of the Code) apply to any determination of an excessive payment, including with respect to the amount of the excessive payment and the 20% penalty amount. The Guidance should

provide all of the normal rights belonging to the taxpayer to challenge and appeal any adjustment to an applicable credit or deficiency in tax.

- Guidance should clarify that only one tax deficiency and penalty may be determined with respect to the same Credit and payment – i.e., no "stacking" of taxes and penalties.

- Guidance should define the term "reasonable cause" consistent with other contexts under the Code in which this term is used in waiving penalties (e.g., § 6664).

E. Partnership Direct Payment Elections. Section 6417(c)(1) provides that "[i]n the case of any applicable credit determined with respect to any facility or property held directly by a partnership..., any election under subsection (a) shall be made by such partnership...." In the case of such an election, the payment is made to the partnership in an amount equal to the credit. Section 6417(c)(2) provides, conversely in this circumstance, that no partner is permitted to make a direct payment election with respect to any applicable credit determined with respect to such facility or property. Although § 6417(c)(1) refers to an election by the partnership, the statute does not expressly describe the partnership as an "applicable entity" and, therefore, the application of § 6417 to partnerships is unclear.

Requested Guidance: Guidance should clarify that a partnership (or S corporation) under § 6417(c)(1) is entitled to make a direct payment election with respect to any Credit under § 6417(d)(1)(B) (§ 45V credit), (d)(1)(C) (§ 45Q credit), and (d)(1)(D) (§ 45X credit), if the Credit is determined with respect to any facility or property held directly by such partnership (or S corporation). Guidance otherwise should clarify that the partnership (or S corporation) is an "applicable entity" in such circumstances.

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Prepared with the assistance of David S. Lowman and Timothy L. Jacobs, Hunton Andrews Kurth LLP.

GE VERNOVA
Our portfolio of energy businesses

Briefing Paper
Comments in Response to Notice 2022-50
Section 6418 Transfer of Certain Credits

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Briefing Paper
Comments in Response to Notice 2022-50
Section 6418 Transfer of Certain Credits

November 4, 2022

The Inflation Reduction Act of 2022, Pub. L. No. 117-169 ("IRA"), permits certain eligible tax credits to be transferred (sold) to an unrelated taxpayer under Section 6418 of the Internal Revenue Code ("Code"),[1] effective for taxable years beginning after December 31, 2022. Eligible tax credits include, in relevant part, the renewable electricity production credit under § 45, the credit for carbon oxide sequestration under § 45Q, the zero-emission nuclear power production credit under § 45U, the clean hydrogen production credit under § 45V, the advanced manufacturing production credit under § 45X, the clean electricity production credit under § 45Y, the clean fuel production credit under § 45Z, the energy credit under § 48, the qualified advanced energy project credit under § 48C, and the clean electricity investment credit under § 48E ("Eligible Credits").

Taxpayers require guidance on the application of the transfer provisions to Eligible Credits, including (i) the transfer of all or any portion of an Eligible Credit and transfers to multiple transferees, (ii) multi-year transfers of Eligible Credits, (iii) clarification of the effective date of § 6418, (iv) partnership and partner allocations, (v) application of the basis reduction and recapture rules, (vi) the administrative process for making transfers and review of transfers, and (vii) application of the excessive credit transfer and penalty (these issues are described together as the "Guidance").

Background

Federal tax law has traditionally prohibited the sale of tax credits and other tax incentives. In order to monetize the value of tax credits, taxpayers have had to engage in "tax equity" transactions through a partnership arrangement or rely on other structures to monetize tax credits that the taxpayer could not itself absorb. *See, e.g.*, Rev. Proc. 2020-12, 2020-11 I.R.B. 495; Rev. Proc. 2007-65, 2007-50 I.R.B. 967. Section 6418, however, provides taxpayers an exclusive opportunity to transfer or sell Eligible Credits if the rules set forth in this Code section are satisfied.

Section 6418(a) allows an eligible taxpayer (the "transferor taxpayer") to elect to transfer all (or any portion specified in the election) of an Eligible Credit determined with respect to such taxpayer for any taxable year to an unrelated taxpayer (the "transferee taxpayer").[2] Eligible taxpayers include any taxpayer which is not described in § 6417(d)(1)(A) (tax-exempt, government, tribal, and electric cooperative entities). § 6418(f)(2). A transfer election must be made no later than the due date (including extensions) of the tax return for the taxable year for

[1] All Section (§) references are to the Code as amended by the Inflation Reduction Act of 2022, Pub. L. No. 117-169.
[2] The transferee taxpayer must not be related within the meaning of § 267(b) or 707(b)(1) to the transferor taxpayer.

which the Eligible Credit is determined and, once made, is irrevocable. § 6418(e)(1). The transferee taxpayer may not make any additional transfer of the transferred credit. § 6418(e)(2). Upon making a transfer election, the transferee taxpayer is treated as the taxpayer for purposes of the Code with respect to such credit (or such portion thereof). § 6418(a). The transferred credit is taken into account in the first taxable year of the transferee taxpayer ending with, or after, the taxable year of the transferor taxpayer with respect to which the credit was determined. § 6418(d).

Under § 6418(b), the consideration for any Eligible Credit transfer is required to be paid in cash, is not includible in gross income of the transferor taxpayer, and is not deductible by the transferee taxpayer. Section 6418(c) provides special rules for an Eligible Credit determined with respect to any facility or property held directly by a partnership (or S corporation) that makes a transfer election – any amount received as consideration for a transfer is treated as tax-exempt income for purposes of §§ 705 and 1366, and a partner's distributive share of that tax-exempt income is based on the partner's distributive share of the otherwise Eligible Credit for each taxable year. § 6418(c)(1). No election by any partner (or shareholder) is allowed with respect to any Eligible Credit determined with respect to such facility or property. § 6418(c)(2).

Under § 6418(f)(1)(B), in the case of Eligible Credits under §§ 45, 45Q, 45V, or 45Y, the transfer election must be made separately with respect to each facility for which the credit is determined, and for each taxable year during the applicable 10- or 12-year credit period beginning on the applicable placed-in-service date.[3] Section 6418(g)(1) provides that, as a condition of, and prior to, any transfer of any portion of an Eligible Credit pursuant to § 6418(a), the Secretary may require such information (including, in such form or manner as is determined appropriate by the Secretary, such information returns) or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments under § 6418.[4]

Section 6418(g)(2) provides special rules for an "excessive credit transfer," which means, with respect to any facility or property for which a transfer election is made for any taxable year, an amount equal to the excess of—(i) the amount of the Eligible Credit claimed by the transferee taxpayer with respect to such facility or property for such taxable year, over (ii) the amount of such credit which, without application of § 6418, would be otherwise allowable under the Code with respect to such facility or property for such taxable year. § 6418(g)(2)(C). In the case of an excessive credit transfer, the income tax imposed on the transferee taxpayer for the taxable year in which such determination is made is increased by an amount equal to the sum of—(i) the amount of such excessive credit transfer, plus (ii) an amount equal to 20% of such excessive credit transfer. § 6418(g)(2)(A). The 20% penalty is not applicable if the transferee taxpayer demonstrates to the satisfaction of the Secretary that the excessive credit transfer resulted from reasonable cause. § 6418(g)(2)(B).

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[3] It should be noted that § 45Q has a special transfer provision at § 45Q(f)(3)(B) where the credit can be transferred to the party sequestering or utilizing the qualified carbon oxide. The special transfer provision in § 45Q(f)(3)(B) should be viewed as separate and distinct from the transfer of Eligible Credits in § 6418 and the owner of the carbon capture equipment can elect to use either provision as long as the requirements of the respective transfer provision are satisfied.

[4] The terms "improper payments" and "excessive payments" appear to have been carried over from § 6417, and should refer consistently to "improper transfers" and "excessive transfers" under § 6418.

Under § 6418(g)(3)(A), in the case of a transfer election of any portion of an Eligible Credit under §§ 48, 48C, or 48E, the recapture provisions of § 50(c) are applied to the applicable investment credit property as if the Eligible Credit was allowed to the transferor taxpayer. If, during any taxable year, the applicable investment credit property is disposed of, or otherwise ceases to be investment credit property with respect to the transferor taxpayer, before the close of the 5-year recapture period (as described in § 50(a)(1))—(i) the transferor taxpayer must provide notice of such occurrence to the transferee taxpayer (in such form and manner as the Secretary prescribes), and (ii) the transferee taxpayer must provide notice of the recapture amount (as defined in § 50(c)(2)), if any, to the transferor taxpayer (in such form and manner as the Secretary prescribes).

Discussion

A. Partial Transfers/Multiple Transferees. The statute does not specifically address whether the transferor taxpayer may offset its income tax liability with a portion of the Eligible Credit and transfer the remaining portion of the Eligible Credit to another taxpayer. Nonetheless, § 6418(a) refers to the "transfer [of] all (*or any portion* specified in the election) of an eligible credit." (Emphasis added.) Section 6418(d), which addresses the taxable year in which the credit is taken into account, similarly refers to "any credit (*or portion thereof*) with respect to which an election is made" under § 6418(a). (Emphasis added.) As well, § 6418(e)(1) and (2) both refer to "any portion of an eligible credit" with respect to the timing of a transfer election and the prohibition on additional transfers. This language is also repeated in § 6418(g)(1), (2), and (3) for additional information, excessive credit transfers, and recapture, respectively. Based on this language and repetition, the statute clearly contemplates that a transferor taxpayer may retain part of the Eligible Credit to use against its own tax liability and transfer the rest. Likewise, this language also contemplates the transfer of an Eligible Credit to multiple transferees and not to a single transferee. The terms "eligible credit" and "transferee taxpayer" should not be read as a limitation on transferability. *See* 1 U.S.C. § 1 ("In determining the meaning of any Act of Congress, unless the context indicates otherwise—words importing the singular include and apply to several persons, parties, or things; words importing the plural include the singular…"). Considering that the volume of Eligible Credits potentially available under the IRA may impact absorption by taxpayers and the need to incentivize timely investment, it is important that the Guidance recognize and support the flexibility of the transfer election.

Requested Guidance. Guidance should confirm:

- The transferor taxpayer may transfer only a portion of any Eligible Credit. This would include the transferor taxpayer retaining a portion of the Eligible Credit for use against its own income tax liability and transfer the remaining portion.

- The transferor taxpayer may transfer any portion of an Eligible Credit to multiple transferees.

- A taxpayer (that is a taxable entity) that has claimed direct pay with respect to the § 45V credit under § 6417(d)(1)(B), the § 45Q credit under § 6417(d)(1)(C), and the § 45X credit under § 6417(d)(1)(D), may elect to transfer all or a portion of Eligible Credits

under § 6418 for any taxable year that the direct pay election under § 6417 is not in effect.

B. Multi-Year Transfers. By permitting the transfer of applicable tax credits, Congress intended to supplement traditional forms of tax equity investments. The apparent policy rationale was that the tax equity market is limited and such traditional tax equity transactions can be expensive. The "partnership flip" structure, commonly used in the context of the production tax credit ("PTC") under § 45, involves an initial fixed contribution of at least 75% of the sum of the fixed capital contributions plus reasonably anticipated contingent capital contributions. *See* Rev. Proc. 2007-65, sec. 4.04, 2007-50 I.R.B. 967. In the case of § 45Q, the fixed contribution must be at least 50% of the sum of the fixed capital contributions plus reasonably anticipated contingent capital contributions. *See* Rev. Proc. 2020-12, sec. 4.04, 2020-11 I.R.B. 511. The calculation of the initial fixed contribution is typically made based on a probability analysis that includes the anticipated future credits. The remainder of the tax equity investor's contributions may be made over the 10- or 12-year credit period as credits are generated. The contingent, future contributions are commonly referred to as "Paygo." The upfront fixed contribution by tax equity typically allows the developer to pay off any construction debt or to recover a substantial portion of its construction-related equity and redeploy such capital to develop other projects.

Section 6418(a) and (f)(1) indicates that the transfer election is made on a facility basis and for each taxable year. Section 6418 does not specifically address, however, the circumstance where Eligible Credits are generated over the 10- or 12-year credit period as the incentivized production or sequestration occurs. In recognition of the flexibility noted above, and in order for transferability to supplement tax equity structures as intended by the IRA, it is important that the transfer provisions be interpreted in a manner that will allow sponsors/developers of renewable energy projects to realize the future value of Eligible Credits upfront to discharge their debt obligations at or near the completion of construction and timely redeploy this capital to the development and construction of other renewable energy projects. Therefore, it is important for sponsors/developers to be permitted to enter into a single transfer agreement with one or more transferee taxpayers covering the Eligible Credits for multiple years, and to allow the transferee taxpayer(s) to make single or multiple upfront cash payments for the future, expected transfers of Eligible Credits, as and when generated during the 10- or 12-year credit period. Section 6418(b) requires that any amount paid by a transferee taxpayer to the transferor taxpayer as consideration for a transfer of an Eligible Credit be paid in cash. This provision does not restrict the timing of this payment or otherwise preclude the single transfer agreement scenario described above.

Requested Guidance: The Guidance should recognize that the transfer of an Eligible Credit may be made under a single transfer agreement with one or more transferee taxpayers that covers multiple taxable years, consistent with how the credits operate, and including the entire 10- or 12-year credit period. The Guidance should confirm that the transferee taxpayer(s) may pay for any such Eligible Credits to be transferred to them over the credit period on an upfront payment basis combined with annual or periodic Paygo payments in order to address any variability in production and applicable credits over the term of the transfer agreement. This assumes that all administrative requirements for an election to be made for each taxable year are satisfied, the amount of the tax credits for such year is identified, and all related information returns or other administrative information are provided as required.

Example 1. Transferor owns a wind farm that generates PTCs over a 10-year credit period from the placed-in-service date. Transferor enters into a forward sales contract with Transferee under which Transferee agrees to pay Transferor a lump-sum cash payment when the wind farm is placed in service based on a P95 level of expected PTCs for the 10-year credit period (i.e., a 95% probability that the wind farm will generate at least the expected level of PTCs over that period). After the wind farm produces the designated level of PTCs, however long that takes, say in year 8, the Transferor will then make ongoing Paygo payments for any additional PTCs over the designated level of production for the remainder of the credit period. Assuming the Transferor and Transferee file all appropriate and required documentation with the IRS on an annual basis, the forward sale/transfer of the tax credits accompanied with future Paygo payments will be respected for tax purposes.

Example 2. Transferor owns a wind farm that generates PTCs over a 10-year credit period from the placed-in-service date. Transferor enters into a forward sales contract with Transferee under which Transferee agrees to pay Transferor a lump-sum cash payment when the wind farm is placed in service based on a P95 level of expected PTCs for the 10-year credit period (i.e., a 95% probability that the wind farm will generate at least the expected level of PTCs over that period). The transfer agreement identifies the expected P95 level of production for each year. After the wind farm produces the designated level of PTCs for a year, the Transferor will then make cash Paygo payments for any additional PTCs generated in that year in excess of the designated level of production. Assuming the Transferor and Transferee file all appropriate and required documentation with the IRS on an annual basis, the forward sale/transfer of the tax credits accompanied with annual Paygo payments will be respected for tax purposes.

C. Effective Date Clarification. IRA § 13801(g) provides that "[t]he amendments made by this section shall apply to taxable years beginning after December 31, 2022," which applies to both the direct payment election under § 6417 and the transfer provision under § 6418. Section 6418(f)(1)(C) provides that the term Eligible Credit does not include any business credit carryforward or business credit carryback determined under § 39. This provision understandably addresses credits generated at a facility before the January 1, 2023 effective date of § 6418. The statute, however, contains no restriction with respect to Eligible Credits that are generated at a facility after December 31, 2022 for a facility that was placed in service prior to the January 1, 2023 effective date. For example, in the case of a qualified wind facility under § 45 that was placed in service before January 1, 2023, PTCs allowed from electricity production and sale prior to this effective date would *not* be permitted to be transferred under § 6418. The taxpayer may, however, make an election to transfer PTCs that are allowable for any taxable year during the remaining part of the 10-year PTC period after December 31, 2022. This interpretation follows, in part, from § 6418(f)(1)(B), which requires a transfer election to be made separately for each taxable year during the 10-year PTC period, as well as by negative inference from the restriction on carryforward and carrybacks in § 6418(f)(1)(C).

Requested Guidance: The Guidance should confirm that PTCs allowable for taxable years beginning after December 31, 2022 are permitted to be transferred, even if the facility to which they relate was placed in service prior to the January 1, 2023 effective date of § 6418.

D. Partnership Transfers/Allocations. Many, if not most, renewable energy tax equity transactions are made through entities that are partnerships for tax purposes. *See, e.g.,* Rev. Proc. 2007-65, *supra.* The industry generally recognizes that § 6418(c) expressly contemplates that it is the partnership, and not the partners, which makes the transfer election under § 6418, and the party that makes the transfer election is the "eligible taxpayer." Section 6418(a) states that, if a transfer election is made, "the transferee taxpayer specified in such election (and not the eligible taxpayer) shall be treated as the taxpayer for purposes of this title with respect to such credit (or such portion thereof)."

In order for the cash benefit received by the transferor partnership to be properly reflected in capital accounts, § 6418(c)(1)(A) provides that "any amount received as consideration for a transfer described in such subsection shall be treated as tax exempt income for purposes of section[] 705 . . .." Section 6418(c)(1)(B) provides that a partner's distributive share of tax-exempt income from the transfer consideration must be "based on such partner's distributive share of the *otherwise eligible credit* for each taxable year." (Emphasis added.) However, the statute does not provide any further guidance regarding the allocation of the "otherwise eligible credit," which is transferred by the partnership to the transferee taxpayer(s). Section 6418(h) expressly authorizes the Secretary to issue regulations or other guidance "as may be necessary to carry out the purposes of this section, *including regulations or other guidance providing rules for determining a partner's distributive share of the tax exempt income described in [§ 6418(c)(1)]*" (emphasis added).

It is widely expected that the partners in a transferor partnership may seek to transfer the credits allocable to only one of the partners. For example, in a typical partnership flip transaction, the sponsor receives allocations of 1% of the PTCs during the pre-flip period. The investor partner receives allocations of 99% of the PTCs for such period. These allocations may flip to 95% sponsor, 5% investor after a specified return is achieved by the investor partner. The partners in the partnership may agree to have the partnership elect to transfer only the 1% of the PTCs allocable to the sponsor partner. Assuming the partnership enters into a valid transfer of that portion of the Eligible Credits, the partners may agree that the cash consideration received by the partnership will be distributed all to the sponsor partner whose portion of the credits was transferred by the partnership. This raises the question of how the tax-exempt income from the transfer should be allocated among the partners for capital account purposes.

In general, § 704(a) provides that a partner's distributive share of partnership income, gain, loss, deduction, or credit ("partnership items") is determined by the partnership agreement. Under § 704 and the regulations, the allocation of partnership items typically must have "substantial economic effect" in order to be respected. *See* § 704(b); Treas. Reg. § 1.704-1(b)(1). Under Treas. Reg. § 1.704-1(b)(4)(ii), allocations of tax credits are not reflected as adjustments to the partners' capital accounts and, therefore, cannot have economic effect under Treas. Reg. § 1.704-1(b)(2)(ii)(b)(1), and the tax credits must be allocated in accordance with the partners' interests in the partnership as of the time the tax credit arises. With respect to any investment tax credit ("ITC") provided by § 38 (including §§ 48, 48C, and 48E credits), allocations of cost or qualified investment made in accordance with Treas. Reg. § 1.46-3(f) are

deemed to be made in accordance with the partners' interests in the partnership.[5] Treas. Reg. § 1.704-1(b)(4)(ii). With respect to tax credits such as PTCs (including §§ 45, 45U, 45V, 45X, and 45Y) that arise from receipts of the partnership, if such receipts in a partnership taxable year also give rise to valid allocations of partnership income (or other upward capital account adjustments) for such year, then the partners' interests in the partnership with respect to such credit (or the receipts giving rise thereto) shall be in the same proportion as such partners' respective distributive shares of such income (and adjustments). Allocations of § 45Q credits follow this same rule if the taxpayer generates receipts from its activities relating to carbon oxide sequestration. Rev. Proc. 2020-12, § 4.09, 2020-11 I.R.B. 511. Otherwise, an allocation of the § 45Q credit in the same proportion as the partners' respective distributive shares of the loss or deduction (or other downward capital account adjustments) associated with the cost of the capture and disposal, use as a tertiary injectant, or utilization of the qualified carbon oxide will be treated as in accordance with the partners' interests in the partnership for this purpose. *Id.*

A partnership should be able to transfer the credits (or a portion) allocable to only one of the partners. While the election is made at the partnership level, the effect of such a transfer is made within the partnership through the allocation of "tax-exempt income" recognized on the transfer of the tax credit allocable to only one of the partners. Specifically, the partnership should be permitted to specially allocate the tax-exempt income among the partners based on their agreement consistent with items that have substantial economic effect. In this case, the tax-exempt income and the cash distribution to the partners affects capital accounts and should have substantial economic effect under § 704. The following example reflects the mechanics for such a sale:

> Example. Partners form a partnership consistent with the requirements of Rev. Proc. 2007-65 to own a wind facility that qualifies for the § 45 tax credit. The investor partner receives a 99% allocation of the PTCs based on a valid allocation of income from the sale of the electricity. The sponsor partner receives a 1% allocation based on a valid allocation of its share of income from the sale of the electricity. The partners agree pursuant to the partnership agreement to transfer the 1% of the Eligible Credits allocable to the sponsor and to distribute the cash proceeds received by the partnership to the sponsor partner. The partnership enters into a valid transfer agreement with an unrelated person to transfer the 1% of Eligible Credits allocable to the sponsor partner for cash consideration payable to the partnership. The partnership is permitted to specify in the transfer agreement and the partnership agreement that the 1% of Eligible Credits sold is the credit allocable to the sponsor. The partnership also is permitted to specially allocate the tax-exempt income from the transfer to the partner whose allocable share of Eligible Credits was sold. The partnership can distribute the cash from the sale consistent with the agreement of the partners.

[5] Under Treas. Reg. § 1.46-3(f)(1), each partner's share of the basis (or cost) of any section 38 property is determined in accordance with the ratio in which the partners divide the general profits of the partnership pursuant to § 702(a)(8) regardless of whether the partnership has a profit or a loss for its taxable year during which the § 38 property is placed in service. However, if the ratio in which the partners divide the general profits of the partnership changes during the taxable year of the partnership, the ratio effective for the date on which the property is placed in service applies. Treas. Reg. § 1.46-3(f)(2)(i). General profits represent the taxable income of the partnership, excluding any items subject to a special allocation (described in §§ 702(a)(1) through 702(a)(7)) under the partnership agreement that differs from the general allocation of partnership taxable income.

The allocation of tax-exempt income to the sponsor partner would appropriately increase its capital account, which would then balance against the cash distributed to such partner. Such a special allocation would keep capital accounts between the partners in balance consistent with how the partners structured the transfer of Eligible Credits and distribution of cash proceeds. Of course, consistent with general tax principles, this example assumes the partnership should be permitted to distribute the cash received from the transfer of the credits among the partners in any manner that the partners agree (including 100% to a specific partner) without regard to how the tax-exempt income or other partnership items may be allocated.

Guidance should also state that any transfer of credits or special allocations or distributions in connection with a transfer of credits under § 6418 will not affect satisfaction of the safe harbor for wind farm partnerships provided under Revenue Procedure 2007-65.[6] Specifically, any special allocations with respect to the transfer of tax credits would not affect satisfaction of the safe harbor under the Revenue Procedure (e.g., as it relates to the example above, the requirement that the developer have a minimum 1% interest in each material item of partnership income, gain, loss, deduction and credit). Distributions of cash from the transfer among partners can be determined by agreement of the partners, also without affecting satisfaction of the safe harbor under the Revenue Procedure.

Under § 6418(c)(1), the partnership is the party that makes the transfer election. For the same reasons discussed earlier, the partnership should be permitted to retain a portion of the Eligible Credit, allocate this portion of the Eligible Credit to the partners in accordance with the partnership agreement, and then transfer the remainder of the Eligible Credit.

Requested Guidance: The Guidance should address the following items with respect to partnerships and partners:

- The Guidance should confirm that the partners in a partnership may agree to designate the tax credits that are transferred specifically to a partner or among the partners. The partners should be able to specially allocate the tax-exempt income from the cash consideration received from a transfer of Eligible Credits in a manner that is consistent with Treas. Reg. § 1.704-1(b)(4)(ii), and the partners may distribute the cash in any manner agreed upon by the partners in the partnership agreement.

- The Guidance should also state that any transfer of credits or special allocations or distributions in connection with a transfer of credits under § 6418 will not affect satisfaction of the safe harbor for wind farm partnerships provided under Revenue Procedure 2007-65.

E. Single Project Election. With respect to certain of the Eligible Credits, specifically §§ 45, 45Q, 45V and 45Y, § 6418(f)(1)(B) provides that an election to transfer the tax credit shall be made—"(i) separately with respect to each facility for which such credit is determined, and (ii) for each taxable year during the 10-year period beginning on the date such facility was originally placed in service (or, in the case of the credit described in clause (iii), for

[6] A similar rule should be provided for the § 45Q tax credit under Rev. Proc. 2020-12.

each year during the 12-year period beginning on the date the carbon capture equipment was originally placed in service at such facility)."

As explained with regard to certain other issues (*see* GE Briefing Paper on the Domestic Content Bonus), Rev. Rul. 94-31 ruled that "each wind turbine together with its tower and supporting pad . . . is a separate facility" and "[e]ach of these facilities is a qualified facility. . . ." The separate facility election therefore raises an issue for wind farms in particular. Wind farms can have a large number of wind turbines, sometimes in the hundreds, each technically a separate qualified facility. Typically, a wind farm will sum all of the PTCs generated in a taxable year and reflect the total of PTCs on its tax return. Such a taxpayer also will typically maintain the production information for each wind turbine in its tax workpapers. Making a separate election with respect to each wind turbine in a large wind farm could present an administrative burden, not only to the taxpayer, but also to the IRS.

Requested Guidance: Treasury should provide in Guidance a single project election under which a taxpayer with multiple facilities, such as a wind farm, can elect to sell/transfer all or a portion of the total PTCs generated for such single project in a taxable year. Treasury and the IRS have previously provided a single project election for purposes of determining whether construction has begun on a project. *See* Notice 2013-29, 2013-1 C.B. 1085. The standards for such a single project election should be used to create a similar election for transfers of tax credits under § 6418.

F. Application of Basis Reduction/Recapture Rules. In the case of Eligible Credits involving an ITC (i.e., §§ 48, 48C, and 48E), § 6418(g)(3)(A) requires that the rules under § 50(c) apply to the applicable investment credit property as if the transferred Eligible Credit was allowed to the transferor taxpayer. Thus, under § 50(c)(1), using the modified percentage of 50% for any energy credit or clean energy investment credit under § 50(c)(3)(A), the transferor taxpayer must reduce its tax basis in the investment credit property by 50% of the ITC credit amount determined with respect to such property. This application is sensible because the transferor taxpayer owns the applicable investment credit property, it is the transferor taxpayer's basis or qualified investment upon which the ITC is grounded, and the transferor taxpayer has recovered a portion of its cost/investment through the transfer of the Eligible Credit. The transferee taxpayer is not required to make any adjustments to basis since it does not own the investment credit property.

In the case of a partnership that owns ITC property, under § 50(c)(5), the adjusted basis of a partner's interest in a partnership must be appropriately adjusted to take into account adjustments made under § 50(c) in the basis of the investment credit property held by the partnership. In the case of a transferred Eligible Credit, the partners in a transferor partnership do not actually receive an allocation of the credit but rather receive an allocation of tax-exempt income consistent with the partners' distributive shares of the "otherwise eligible credit" under § 6418(c)(1)(B). In these circumstances, the basis reduction prescribed under § 50(c)(5) should be made in a manner consistent with the allocation of tax-exempt income (as discussed earlier). Generally, a partner who receives an allocation of tax-exempt income on account of a transferred credit would receive a reduction in its outside basis consistent with the 50% reduction amount under § 50(c)(1) and (3). Thus, a partnership that owns ITC property should be able to specially

allocate the tax-exempt income and the corresponding adjustment to partnership basis based on the agreement of the partners with respect to a sale of a portion of the ITC.

Under § 6418(g)(3)(B), a recapture event includes a circumstance in which the investment credit property is disposed of, or otherwise ceases to be investment credit property with respect to the transferor taxpayer. These same terms are used to define a recapture event under § 50, and they should be construed consistently. Importantly, Treas. Reg. § 1.47-2 defines the terms "disposition" and "cessation" for ITC recapture purposes, and those terms have a well-established meaning under the ITC with respect to this regulation. Likewise, Treas. Reg. § 1.47-3 provides longstanding exceptions to those rules, including Treas. Reg. § 1.47-3(f), which deals with a mere change in form of the taxpayer's business. Finally, Treas. Reg. § 1.47-6 includes rules for partnerships, including the disposition of partner's interests in the partnership, which are commonly referenced by tax practitioners and applied by taxpayers in the renewable industry. Section 6418(c)(3)(B) should be applied in a manner that is consistent with those regulations and longstanding rules.

Under § 6418(g)(3)(B), in the case of a recapture event before the close of the recapture period (as described in § 50(a)(1)), the transferor taxpayer is required to provide notice of the recapture event to the transferee taxpayer "in such form and manner as the Secretary shall prescribe," and the transferee taxpayer is required to provide notice of the recapture amount (as defined in § 50(c)(2)), if any, to the transferor taxpayer, again "in such form and manner as the Secretary shall prescribe." Section 50(a)(1) provides for a 5-year recapture period and annual recapture percentages that start at 100% and decrease by 20% each year until reaching zero at the end of the fifth-year anniversary of the placed-in-service date for the investment credit property. Thus, the recapture percentages are 100% if the investment credit property is disposed of, or if it ceases to be investment credit property, within one full year after the placed-in-service date; 80% within the second year; 60% within the third year; 40% within the fourth year; and 20% within the fifth year after the placed-in-service date. After the fifth-year anniversary, the credit is fully vested and no longer subject to recapture. Recapture is taken into account by the taxpayer by increasing the taxpayer's income tax for the taxable year within which the recapture event occurred and by the applicable recapture percentage.

Under § 50(c)(2), if during any taxable year there is a recapture amount determined with respect to any investment credit property the basis of which was reduced under § 50(c)(1), then the basis of such property (immediately before the event resulting in such recapture) must be increased by an amount equal to such recapture amount. For purposes of this basis increase, the recapture amount is the increase in tax determined under § 50(a)(1) (or adjustment in carrybacks or carryovers under § 50(a)(4) with respect to unused credits under § 39), but the basis increase is limited to 50% of the recapture amount because it is energy credit or clean energy investment credit property under § 50(c)(3)(B) – consistent with the original basis reduction.

Section 6418(g)(3) does not specifically address the application of the recapture rules to the transferor taxpayer and the transferee taxpayer. Rather, § 6418(g)(3)(A) applies the basis reduction rules of § 50(c)(1) and (3) to the transferor taxpayer, and § 6418(g)(3)(B) provides for reciprocal notices – from the transferor taxpayer to the transferee taxpayer of a recapture event and, conversely, from the transferee taxpayer to the transferor taxpayer of the recapture amount.

Nonetheless, the application of the recapture rules may be inferred from the statutory language, including the statutory sequence of notices, the incorporation of the § 50(a)(1) increase in tax and recapture percentages, and the § 50(c) basis reduction and recapture adjustment rules. The example below illustrates the application of these rules in the context of a transferred credit:

> Example. The transferor taxpayer (X), an eligible taxpayer, owns investment credit property under § 48 that has an eligible cost basis of $100 and that qualifies for the increased credit rate of 30%, resulting in a $30 ITC. X transfers the entire amount of this $30 ITC to another taxpayer (Y). X must reduce its basis in the investment credit property by $15 (i.e., 50% of the value of the ITC determined) under § 50(c)(1) and (3) – resulting in an adjusted basis of $15 (which is a reduction in basis available for depreciation allowances to X). Within the third full year following the placed-in-service date, the property has a recapture event (i.e., disposition or cessation of use), resulting in a 60% recapture percentage under § 50(a)(1) and a $18 recapture amount. X must provide notice to Y of the recapture event under § 6418(g)(3)(B)(i) and Y must provide notice to X of the recapture amount under § 6418(g)(3)(B)(ii). Y, as the taxpayer with respect to the transferred Eligible Credit, must increase its income tax by the $18 recapture amount in the taxable year within which the recapture event occurred. X, as the taxpayer who originally reduced its basis under § 50(c)(1) on account of the Eligible Credit, must increase its adjusted basis in the applicable investment credit property by $9 under § 50(c)(2) after application of § 50(c)(3)(B).

In the case of a partnership, any recapture amount should be allocated to the partners in a manner that is consistent with the earlier discussion of the allocation of tax-exempt income and the reduction in the outside basis of the partners' interests in the partnership.

Requested Guidance: The Guidance should address the following items with respect to the basis reduction and recapture provisions in § 6418(g)(3):

- The application of the basis reduction and recapture rules is not clear under § 6418(g)(3). Importantly, the Guidance should clarify whether the increase in tax required under § 50(a)(1) is to be made with respect to the transferor taxpayer or the transferee taxpayer(s) and explain the interplay between the corresponding basis reductions or increases with the applicable recapture amount. The Guidance should clarify these rules with examples.

- The Guidance should confirm that the longstanding definitions and rules relating to "disposition" and "cessation" are applicable under § 6418(g)(3), including the portions of the ITC regulations under § 47 that are applicable (e.g., Treas. Reg. §§ 1.47-2, -3, and -6).

- The Guidance should clarify the application of the basis reduction and recapture rules to partnerships. The Guidance likewise should clarify these rules with examples.

G. Administrative Process/Review: Section 6418(g)(1) provides: "As a condition of, and prior to, any transfer of any portion of an eligible credit pursuant to subsection (a), the Secretary *may* require such information (including, in such form or manner as is determined

appropriate by the Secretary, such information returns) or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments under this section." (Emphasis added.) It is important that the Guidance address the concerns set forth by Congress in § 6418(g)(1) and adopt sensible procedures that prevent abuse that would undermine the statutory goals of the IRA. We fully support such procedures. At the same time, as noted earlier, it is important that taxpayers have access to cash consideration on a timely basis near the completion of the applicable facility or property. In this regard, it is important that the Secretary exercise the discretion provided by Congress in § 6418(g)(1) with this objective in mind and not impose an unnecessary review process that may delay transfers from occurring and create uncertainty among both transferor and transferee taxpayers.

As Congress has suggested, the concerns expressed in the statute may be addressed with information returns filed by the transferor taxpayer and/or a registration process. In either case, the required information may include the specific facility or property, the amount of the Eligible Credit for such facility or property, the calculation of the Eligible Credit, the portion of the Eligible Credit retained, if any, and the portion of the Eligible Credit transferred, as well as identifying information for the transferee taxpayer(s). Registration may be accomplished by the registration of the transferor and/or transferee taxpayer through the Data Universal Numbering System (DUNS) and/or System for Awards Management (SAM), which have been used in other federal programs. Unique identifying numbers may be assigned by specific facility or property so that the IRS may verify that the total amount of the Eligible Credit reported by the transferor taxpayer is not exceeded on by the transferee taxpayer(s) or claimed by outside parties who are not legitimate transferees. These measures, by and large, should preclude many of the concerns Congress noted and/or allow the IRS to immediately identify and address errors and abuse.

The Guidance should not implement a preliminary review or audit process by the IRS or any other agency as a condition of, and prior to, any transfer. This type of process would have a detrimental effect on the rapid infusion of capital into renewable energy projects. If some form of review process is deemed necessary by the Secretary, then the review process should be a "first look" review to verify that all legal requirements have been satisfied, that the transferor taxpayer is an eligible taxpayer, and that there is no evident disqualifying factor, improper payment, or excessive payment with respect to the applicable facility or property. Any "first look" review should be conducted in a timely manner in advance of any tax return filings by the transferee taxpayer(s). Factual issues such as eligible property, basis, cost segregation, and valuation should be addressed in a manner consistent with regular IRS examination selection and procedures. Transfer of an Eligible Credit should not be a factor, in and of itself, for selection for examination.

The Guidance should clarify the application of the transfer provisions under § 6418 to estimated tax payment obligations. Under § 6418(a), the transferee taxpayer "shall be treated as the taxpayer for purposes of this title [i.e., the Code] with respect to such credit (or such portion thereof)." The Code includes the provisions relating to estimated tax payments. Section 6418 does not otherwise address estimated tax payments. The transferee taxpayer should be able to take any Eligible Credits into account in the same manner as the transferor taxpayer otherwise would be permitted to do. Specifically, with respect to a corporation, any Eligible Credit that has been transferred should be available as an offset against quarterly estimated tax payments. For

example, the Guidance should permit the transferee taxpayer (in the case of a corporation) to report any transferred credits on line 3 of the Form 1120-W, Estimated Tax for Corporations (or the equivalent line for taxable years after 2022) and/or Form 3800, General Business Credit, in order to offset quarterly estimated tax payments. Moreover, the transferred credits should be available for reporting and offset on Schedule J, Tax Computation and Payment, Part I – Tax Computation, of the Form 1120, U.S. Corporation Income Tax Return, in the calculation of the taxpayer's taxes due. Taxpayers who purchase Eligible Credits should be entitled to use those credits against estimated taxes and appropriate consideration should be given to the application of § 6655 and the associated regulations with respect to the timing of the transferred credits so that estimated tax penalties are not inadvertently triggered as a result of any administrative delay in the application of the transferred credit.

Requested Guidance: The Guidance should confirm or clarify the following items:

- The Guidance should adopt flexible procedures for taxpayers to supply information necessary to verify the transfer of Eligible Credits and to prevent errors and abuse. Those procedures should be limited to information returns and/or registration as Congress has suggested in the statute.
- The Guidance should not impose any preliminary review or audit process that impedes the ability of taxpayers to transfer Eligible Credits on a timely and efficient basis and for transferee taxpayers to claim the Eligible Credits on their tax returns.
- The Guidance should confirm and clarify the application of the transfer provisions under § 6418 to estimated tax payment obligations by specifically allowing taxpayers to offset their quarterly estimated taxes with transferred credits (without penalty under § 6655).

H. Excessive Credit Transfer/Penalty. Section 6418(g)(2) provides rules relating to an excessive credit transfer, defined generally as the excess of the amount of the Eligible Credit claimed over the amount allowable for any taxable year. Section 6418(g)(2)(A) describes a process whereby the Secretary makes a determination of an excessive credit transfer, which may result in an increase in the tax imposed on the transferee taxpayer equal to the sum of the amount of the excessive credit transfer and an amount equal to 20% of the excessive credit transfer. The latter amount is subject to being waived if it is determined that the excessive credit transfer resulted from reasonable cause. § 6418(g)(2)(B). The statute provides no further guidance regarding the determination of the excessive credit transfer. Importantly, § 6418(g)(2) does not address the procedures applicable to this determination and the conduct of any review or examination by the IRS or other agency. These matters should be clarified in the Guidance.

For example, § 6418(g)(2)(A) states that "the tax imposed on *the transferee taxpayer* ... shall be increased by an amount" (emphasis added) that includes the two components noted above. However, it is not clear from the statute whether the transferee taxpayer, the transferor taxpayer, or both parties would be the subject of examination and, indeed, whether the item being examined is a tax return (and, if so, which party's tax return) or the Eligible Credit or both. In the normal course, it is our expectation that the vast majority of the information in order to evaluate the Eligible Credit will be in the possession of the transferor taxpayer, but the statute

suggests that the tax burden falls on the transferee taxpayer(s) – the party or parties that actually reported the Eligible Credit against a tax liability on an income tax return.

Further, § 6418(g)(2)(A) states only that the transferee taxpayer's income tax is increased but does not address the assessment and collection of this tax. Other provisions in the Code and the IRA, such as the penalty for failure to pay prevailing wages in § 45(b)(7)(B), include a specific reference to deficiency procedures and state that those procedures do not apply. *See* § 45(b)(7)(B)(ii). On the other hand, § 6418(g)(2)(A) says nothing about deficiency procedures. The party responsible for any excessive credit transfer amount and any party subject to examination for an excessive credit transfer should have the right to challenge and/or appeal any adverse determination by the IRS or other agency. Such party or parties should have the right to appeal any determination to the IRS Independent Office of Appeals and deficiency procedures should apply.

Further, § 6418(g)(2)(A) states that "the tax imposed on the transferee taxpayer ... for the taxable year in which such determination is made shall be increased by an amount ...." This language requires clarification. Specifically, the term "taxable year" should be clarified to mean the taxable year in which the Eligible Credit was allowable, and not to some later period that the determination is made. That is, the transferor taxpayer and any transferee taxpayer should only be responsible for a single deficiency in tax with respect to the same tax amount corresponding to an Eligible Credit claimed on a tax return.

Finally, § 6418(g)(2)(B) does not define the term "reasonable cause." In particular, § 6664 includes a reasonable cause exception to accuracy-related penalties otherwise applicable to income tax underpayments under § 6662. Numerous tax cases and other authorities have applied this exception and the factors for establishing reasonable cause under § 6664 are relatively well-established. Treas. Reg. § 1.6664-4(b) describes the facts and circumstances that are taken into account to establish reasonable cause, stating generally:

> The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. ... Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer.

The regulation continues with specific examples and circumstances. Treas. Reg. § 1.6664-4(c) addresses whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the taxpayer's treatment of tax items. The Guidance should also clarify that the transferee taxpayer is entitled to rely in good faith on factual information provided by the transferor taxpayer relating to the Eligible Credit, provided the transferee taxpayer otherwise has made reasonable efforts to conduct appropriate due diligence under the circumstances with respect to the Eligible Credit.

Requested Guidance: The Guidance should confirm and/or clarify the following matters with respect to the determination of an excessive credit transfer and the 20% penalty amount:

- The Guidance should provide specific procedures for the examination of an Eligible Credit and the determination of any excessive credit transfer, including the application of the procedures under subtitle F of the Code and the assessment and collection of any excessive credit transfer and penalty amount.
- The Guidance should clarify which party (transferor taxpayer, transferee taxpayer, or both taxpayers) and which item (credit, return, or both) are subject to examination by the IRS or other agency.
- The Guidance should confirm that deficiency procedures (subchapter B of chapter 63 of the Code) apply to any determination of an excessive credit transfer, including with respect to the amount of the excessive credit transfer and the 20% penalty amount. The Guidance should provide all of the normal rights of the transferor taxpayer or transferee taxpayer to challenge and appeal any adjustment to an Eligible Credit or deficiency in tax.
- The Guidance should clarify that only one tax deficiency and penalty may be determined with respect to the same Eligible Credit – i.e., no "stacking" of tax and penalties including any "stacking" of tax and penalties with respect to the transferor taxpayer and transferee taxpayer for the same credit amount.
- The Guidance should define the term "reasonable cause" consistent with other contexts under the Code in which this term is used in waiving penalties (e.g., § 6664).

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Briefing Paper
Comments in Response to Notice 2022-51
Prevailing Wage/
Apprenticeship Requirements

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November 4, 2022

The Inflation Reduction Act of 2022, Pub. L. No. 117-169 ("IRA"), eliminated the phase-out of the production tax credit ("PTC") for wind and other renewable energy projects under § 45 of the Internal Revenue Code ("Code")[1] and provides an increased credit amount for satisfaction of certain prevailing wage and apprenticeship requirements ("PWA") for qualified facilities producing electricity from wind placed in service after December 31, 2021. The IRA extends the application of the PWA requirements to a number of other energy tax credits, including, among other credits, the investment tax credit ("ITC") under § 48, the PTC for carbon oxide sequestration under § 45Q, the clean hydrogen production credit under § 45V, the clean electricity production credit under § 45Y, and the clean electricity investment credit under § 48E.

Taxpayers require guidance on the application of the PWA requirements to the various tax credits, including (i) the scope of application of the Davis-Bacon Act, 40 USC 3141 et seq. ("Davis-Bacon") to the PWA requirements, (ii) the definition of "laborers and mechanics," as well as workers excluded from prevailing wage rates, (iii) the meaning of the phrase "construction, alteration, or repair" and its application to a qualified facility or energy project, (iv) the geographical area included within this scope of work, including projects that span multiple counties or other localities, (v) determination of the prevailing wage rate and the proper classification of projects, (vi) application of the curative payment rules for PWA and the meaning of "intentional disregard," (vii) confirmation that the apprenticeship requirements do not apply after completion of construction, and (viii) confirmation that the PWA requirements are not applicable, and the full tax credit rate applies, if construction of a qualified facility or energy project is begun prior to the IRS issuing full guidance related to these issues, within the timeframe set forth in § 45(b)(6)(B)(ii) or similar timeframes for the other credits described above (these issues are described together as the "Guidance").

Background

While the application of the PWA requirements should generally be consistent under the various tax credits, there may be differences in scope and application based on how a qualified facility or other applicable energy project is defined for purposes of a particular tax credit. For purposes of our discussion here, we focus on the § 45 PTC applicable to qualified wind facilities. Under the IRA, the current full 100% PTC rate, for qualified facilities placed in service after December 31, 2021, is $27.50 per megawatt hour ("MWh") if the qualified facility is one of the following—(i) a facility with a maximum net output of less than 1 megawatt ("MW") (as measured in alternating current), (ii) a facility the construction of which begins prior to the date

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[1] All Section (§) references to the Code are as amended by the Inflation Reduction Act of 2022, Pub. L. No. 117-169.

that is 60 days after guidance is published with respect to the PWA requirements of § 45(b)(7) and (8), or (iii) a facility which satisfies the PWA requirements of § 45(b)(7) and (8). § 45(b)(6). The realization of the full value of the bonuses (e.g., the domestic content and energy community bonuses under § 45(b)(9) and (11)), in turn, depends on satisfaction of these requirements.

In order to satisfy the prevailing wage requirement with respect to any qualified facility, § 45(b)(7)(A) provides that:

> the taxpayer shall ensure that any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in—(i) the construction of such facility, and (ii) with respect to any taxable year, for any portion of such taxable year which is within the [10-year PTC] period [beginning on the date the facility was originally placed in service], the alteration or repair of such facility, shall 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, in accordance with subchapter IV of chapter 31 of title 40, United States Code [i.e., Davis-Bacon].

For purposes of determining whether the full 100% PTC rate applies under § 45(b)(6)(A), the requirement under clause (ii) of § 45(b)(7)(A), in the excerpt above, is applied to such taxable year in which the alteration or repair of the qualified facility occurs.

With respect to the ITC, § 48(a)(9)(A)(i) provides that the increased credit amount of 30% applies in the case of any energy project that satisfies the requirements of § 48(a)(9)(B). Similar to the PTC, § 48(a)(9)(B) provides that an energy project meets those requirements if it is one of the following: (i) a project with a maximum net output of less than 1 MW of electrical (as measured in alternating current) or thermal energy, (ii) a project the construction of which begins before the date that is 60 days after the Secretary publishes guidance with respect to the PWA requirements, or (iii) a project which satisfies the PWA requirements. For this purpose, the term "energy project" is defined more broadly to include "a project consisting of one or more energy properties that are part of a single project." § 48(a)(9)(A)(ii).

With respect to the ITC, § 48(a)(10)(A) provides that with respect to any energy project, the taxpayer must ensure that "any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in—

> (i) the construction of such energy project, and
> (ii) for the 5-year period beginning on the date such project is originally placed in service, the alteration or repair of such project,

shall 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 project is located as most recently determined by the Secretary of Labor, in accordance with subchapter IV of chapter 31 of title 40, United States Code." The closing language in § 48(a)(10)(A) provides that, subject to the recapture rules in subparagraph (C), the taxpayer will be deemed to satisfy the requirement in clause (ii) above (regarding alteration or repair) at the time the energy project is placed in service for

purposes of applying the increased 30% ITC rate under § 48(a)(9)(A)(i) to the taxable year such project is placed in service. Section 48(a)(10)(C) provides recapture rules for any failure to satisfy the prevailing wage requirement in § 48(a)(10)(A) – with the period and percentage of such recapture determined under rules similar to § 50(a) (i.e., a 5-year period with incremental 20% vesting at each anniversary of the placed-in-service date).

In order to satisfy the apprenticeship requirement with respect to any qualified facility, § 45(b)(8)(A)(i) provides that:

> Taxpayers shall ensure that, with respect to the construction of any qualified facility, not less than the applicable percentage of the total labor hours of the construction, alteration, or repair work (including such work performed by any contractor or subcontractor) with respect to such facility shall, subject to subparagraph (B), be performed by qualified apprentices.

The "applicable percentage" depends on when construction of the qualified facility begins—10% if before January 1, 2023; 12.5% if after December 31, 2022 and before January 1, 2024; and 15% if after December 31, 2023. § 45(b)(8)(A)(ii). "Labor hours" means "the total number of hours devoted to the performance of construction, alteration, or repair work by any individual employed by the taxpayer or by any contractor or subcontractor," excluding any hours worked by "foremen, superintendents, owners, or persons employed in a bona fide executive, administrative, or professional capacity" (within the meaning of 29 CFR part 541). § 45(b)(8)(E)(i). A "qualified apprentice" is "an individual who is employed by the taxpayer or by any contractor or subcontractor and who is participating in a registered apprenticeship program, as defined in section 3131(e)(3)(B)." Under § 45(b)(8)(B), the labor hours requirement is subject to "any applicable requirements for apprentice-to-journeyworker ratios" established by the U.S. Department of Labor ("DOL") or applicable State apprenticeship agency. Under § 45(b)(8)(C), "[e]ach taxpayer, contractor, or subcontractor who employs 4 or more individuals to perform construction, alteration, or repair work with respect to the construction of a qualified facility shall employ 1 or more qualified apprentices to perform such work."

The PWA requirements contain an opportunity to cure any failure to satisfy one or both of those requirements. As to the prevailing wage requirement, the taxpayer is "deemed to have satisfied such requirement" if it pays to each affected laborer or mechanic the difference between what they actually were paid and should have been paid at the prevailing wage rate, with interest, and the taxpayer also pays a penalty to the Secretary. § 45(b)(7)(B)(i). The payments are increased where the failure is due to intentional disregard. § 45(b)(7)(B)(iii). In the case of "a final determination by the Secretary," with respect to a failure by the taxpayer to satisfy the prevailing wage requirement, the payments must be made by the taxpayer "on or before the date which is 180 days after the date of such determination." § 45(b)(7)(B)(iv). Under § 45(b)(7)(B)(ii), the penalty payment to the Secretary is not subject to deficiency procedures. As to the apprenticeship requirement, the taxpayer shall not be treated as failing such requirement if such taxpayer (i) has made a good faith effort to request qualified apprentices from a registered apprenticeship program, or (ii) pays a penalty to the Secretary, increased if the failure is due to intentional disregard. § 45(b)(8)(D). Section 48(a)(10)(B) provides that rules similar to the correction and penalty rules of § 45(b)(7)(B) apply for purposes of the ITC.

Under § 45Q(h), rules similar to § 45(b)(6) (increased credit amount), § 45(b)(7) (prevailing wage), and § 45(b)(8) (apprenticeship) apply to the § 45Q carbon oxide sequestration credit. For purposes of the §§ 45Y and 48E clean electricity production and investment credits, rules similar to the PWA requirements in § 45(b)(7) and (8) are cross-referenced. *See* §§ 45Y(g)(9), (10); 48E(d)(3), (4). For purposes of the clean hydrogen production credit under § 45V, an increased credit amount applies if a qualified clean hydrogen production facility is one of the following—(i) a facility the construction of which begins prior to the date that is 60 days after the Secretary publishes guidance with respect to the PWA requirements, *and* which meets the prevailing wage requirements with respect to alteration or repair of such facility which occurs after such date, or (ii) a facility which satisfies all of the PWA requirements. § 45V(e)(1), (2). This is a different formulation from the other credits above for application of the increased credit amount. Section 45V(e)(3) then provides prevailing wage requirements similar to § 45(b)(7) with respect to the qualified facility. Section 45V(e)(4) cross-references rules similar to § 45(b)(8) for apprenticeships.

Discussion

A. Application of Davis-Bacon. The extent of the application of Davis-Bacon and related labor laws should be clarified in the Guidance to be limited to the specific sections referenced in the statute – i.e., "subchapter IV" or 40 USC 3141-3148 – and to the specific terms that are derived from Davis-Bacon and that are used in § 45(b)(7) and (8) and § 48(a)(10), as well as the similar PWA provisions included in the other credits described above. Davis-Bacon applies generally to Federal or District of Columbia contracts in excess of $2,000 with respect to the construction, alteration, or repair of public buildings or public works. By its terms, it does not apply directly to privately-financed projects – and, importantly, generally does not apply to tax credits like the ones here.

Requested Guidance: The Guidance should apply the PWA requirements in a manner consistent with Davis-Bacon, as the statute indicates, but should be applied flexibly consistent with Congress' intent to mobilize renewable energy projects quickly and efficiently. Certain provisions, such as the inclusion of the detailed contractual standards in 29 CFR 5.5, and enforcement provisions not otherwise referenced in the IRA, should not be applied. Other related labor acts such as the McNamara-O'Hara Service Contract Act ("SCA"), the Walsh-Healey Public Contracts Act, the Copeland Act, and other labor enactments, executive orders, rules, or guidance should not apply. In addition, the Guidance should recognize the unique application of the Davis-Bacon rules to renewable energy projects under the tax laws and apply the PWA requirements in a manner that provides certainty and flexibility to taxpayers, project owners, developers, contractors, and subcontractors.

B. Definition of Laborers and Mechanics. The statute expressly limits the prevailing wage requirement to two types of employees, laborers and mechanics, which are defined under Davis-Bacon as follows: "those workers whose *duties are manual or physical in nature* (including those workers who use tools or who are performing the work of a trade), *as distinguished from mental or managerial*." 29 CFR 5.2(m) (emphasis added). Laborers and mechanics include apprentices, but the Guidance should recognize that such apprentices are not required to be paid prevailing wage rates if they are qualified as such under 29 CFR 5.2(n)(1)

and 5.5(a)(4)(i). A laborer or mechanic does not include "workers whose duties are primarily administrative, executive, or clerical, rather than manual. Persons employed in a bona fide executive, administrative, or professional capacity" are not laborers or mechanics. 29 CFR 5.2(m).[2] Thus, architects, engineers, technicians, draftspersons, inspectors, timekeepers, and similar workers should not be treated as laborers or mechanics.

Although the statute refers to the taxpayer, in addition to contractors and subcontractors, the Guidance should clarify that the taxpayer's employees normally would not be required to be paid a prevailing wage rate unless they are performing manual or physical labor during the construction phase of the project or any specific and identifiable alteration or repair work during the 10-year PTC period described in § 45(b)(7)(A)(ii) or the 5-year ITC period described in § 48(a)(10)(A)(ii) (see discussion below regarding alteration or repair work). Specifically, the Guidance should recognize that, in normal circumstances, the taxpayer's employees will fall into the categories excluded under § 45(b)(8)(E)(i)(II) – i.e., foremen, superintendents, owners, or persons employed in a bona fide executive, administrative, or professional capacity (*see* 29 CFR part 541). Further, although this exclusion is included in the apprenticeship requirement and the definition of "labor hours," it should apply to the PWA requirements generally – as noted above, the same exclusions apply under Davis-Bacon to laborers and mechanics.

Material suppliers normally are <u>not</u> covered by Davis-Bacon and are not required to be paid a prevailing wage rate.[3] Thus, the manufacture and delivery to the work site of supply items such as sand, gravel, and ready-mixed concrete, when accomplished by material suppliers operating facilities that serve the public generally, are not covered by Davis-Bacon, even if those materials are delivered directly into a contractor's mixing facilities at the work site. If a material supplier, manufacturer, or carrier undertakes to perform a part of a construction contract as a subcontractor, its laborers or mechanics employed at the site may be subject to Davis-Bacon. The Guidance should clarify, consistent with Davis-Bacon, that this circumstance does not apply where such work at the project site involves only an "incidental" amount of construction, alteration, or repair work, and confirm generally that material suppliers will not typically be covered by the PWA requirements.

Under Davis-Bacon, only employees who perform work at the covered project site or a dedicated secondary site (see discussion on site of work below) are subject to prevailing wage rates, and then only for the specific time spent onsite. For example, truck drivers, employed by taxpayers, contractors, or subcontractors, should not be subject to the PWA requirements unless they actually perform work at the work site.[4] The Guidance should confirm that truck drivers and similar employees are not treated as laborers or mechanics where they spend only a *de minimis* amount of time at the site. Further, consistent with case law, the Guidance should confirm that *only* work performed by a laborer or mechanic at the project site is subject to the payment of prevailing wage rates – i.e., prevailing wage rates would not be required to be paid

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[2] These terms are more specifically defined in 29 CFR part 541, *available at* https://www.ecfr.gov/current/title-29/subtitle-B/chapter-V/subchapter-A/part-541. *See, e.g.*, 29 CFR 541.100 et seq. ("employee employed in a bona fide executive capacity"); 29 CFR 541.200 et seq. ("employee employed in a bona fide administrative capacity"); 29 CFR 541.300 et seq. ("employee employed in a bona fide professional capacity").

[3] *See, e.g.*, U.S. Department of Labor, Wage and Hour Division, Field Operations Handbook, sec. 15e16 (as revised Oct. 25, 2010), *available at https://www.dol.gov/agencies/whd/field-operations-handbook/Chapter-15*.

[4] Field Operations Handbook, *supra* fn.3, sec. 15e22(b)(1)-(3).

for work performed by a particular employee at other locations outside of the project site.[5]

Requested Guidance: The Guidance should confirm and/or clarify the following matters regarding the terms "laborers and mechanics" as used in the PWA requirements:

- Specifically define the key terms "laborers and mechanics" and limit the scope of the employees required to be paid prevailing wage rates consistent with Davis-Bacon.

- Off-site employees, foremen, superintendents, owners, executives, administrative personnel, and professionals, including architects, engineers, technicians, draftspersons, inspectors, and similar workers should be specifically excluded from the PWA requirements.

- The Guidance should clarify that employees of the taxpayer are not required to be paid prevailing wages and not subject to the apprenticeship requirements unless performing construction work that would typically be performed by a contractor's or subcontractor's employees.

C. <u>Construction, Alteration, or Repair Work</u>. The phrase "construction, alteration, or repair" is used in both the prevailing wage and apprenticeship requirements under § 45(b)(7) and (8) for the PTC, and in § 48(a)(10) for the ITC. Those terms are derived from Davis-Bacon. The Davis-Bacon regulations define them as "[a]ll types of work done on a particular building or work at the site thereof, including work at a facility which is deemed a part of the site of the work ... [performed] by laborers and mechanics employed by a construction contractor or construction subcontractor," including in relevant part "[a]ltering, remodeling, installation (where appropriate) on the site of the work of items fabricated off-site" and "[m]anufacturing or furnishing of materials, articles, supplies or equipment on the site of the building or work...." 29 CFR 5.2(j)(1). The definition includes "[p]ainting and decorating," which the Guidance should clarify is not relevant in the context of a qualified wind facility (or other renewable energy facility). The regulations, in the definition of "building or work," include "excavating, clearing, and landscaping." 29 CFR 5.2(i). The Guidance should clarify that this work applies only to construction work, during the construction phase of the project, and not to any regular upkeep and maintenance of the project site.

"[T]he transportation of materials or supplies to or from the site of the work by employees of the construction contractor or a construction subcontractor is not 'construction, prosecution, completion, or repair'...." 29 CFR 5.2(j)(2). Rather, the regulations specifically limit transportation activities to (a) transportation between the construction site and a facility dedicated to the construction site, and (b) transportation of significant portions of the construction work from a location, treated as part of the site of the work, to final physical place(s) where it will remain. 29 CFR 5.2(j)(1).

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[5] *Building and Construction Trades Department, AFL-CIO v. U.S. DOL Wage Appeals Board (Midway Excavators, Inc.)*, 932 F.2d 985 (D.C. Cir. 1991) (truck drivers transporting offsite materials to the project site not covered by Davis-Bacon); *see also Ball, Ball & Brosamer, Inc. v. Reich*, 24 F.3d 1447 (D.C. Cir. 1994) (workers in borrow pits and batch plants located two miles from construction site not covered by Davis-Bacon); *L.P. Cavett Co. v. U.S. DOL*, 101 F.3d 1111 (6th Cir. 1996) (truck drivers hauling asphalt from temporary batch plant to highway construction project not covered by Davis-Bacon).

Under 29 CFR 5.2(j)(1), the terms "construction, prosecution, completion, or repair" mean "[a]ll types of work done on a particular building or work at the site thereof, including work at a facility which is deemed a part of the site of the work." The term "building or work" is then defined under 29 CFR 5.2(i), which distinguishes between "construction activity" and offsite "manufacturing"—defining "building or work" to generally include "construction activity as distinguished from manufacturing, furnishing of materials, or servicing and maintenance work." The regulation further states: "The manufacture or furnishing of materials, articles, supplies or equipment ... is not a building or work [covered by Davis-Bacon] ... unless conducted in connection with and at the [project] site." 29 CFR 5.2(i). Similarly, 29 CFR 5.2(j)(1) provides that the terms "construction, prosecution, completion, or repair" include "[m]anufacturing or furnishing of materials, articles, supplies or equipment on the site of the building or work," but this definition does not include offsite manufacturing.

Installation work performed in conjunction with supply or service contracts is not covered by Davis-Bacon unless it involves more than an incidental amount of construction activity and such work is physically or functionally separate from, and can be performed on a segregated basis from, the other non-construction work called for by the contract.[6] Davis-Bacon does not apply to construction work which is incidental to the furnishing of supplies or equipment, if the construction work is so merged with non-construction work or so fragmented in terms of the locations or time spans of its performance that the construction work is not capable of being segregated as a separate contractual requirement.[7] The definition of "construction, alteration, or repair" generally does not include *development work* (i.e., exploratory, preparatory, pre-construction work at the project site), except with respect to specific statutes not relevant here, *see* 29 CFR 5.2(j)(1).

Neither the IRA nor Davis-Bacon specifically define "alteration or repair," as used in the statute, other than the general definition contained in 29 CFR 5.2(j) above. However, a range of authorities used to resolve the application of Davis-Bacon versus the SCA, 41 USC 351-358 (which does not apply to PWA), illustrates the limits of Davis-Bacon and these terms. Under these authorities, it is necessary to determine whether "items of work involve basic maintenance within the coverage of the SCA, or are more in the nature of construction, alteration, or repair within the scope of [Davis-Bacon]...." Comp. Gen. Opin., *Matter of Ameriko, Inc.*, 1996 WL 164510 (Mar. 18, 1996); *cf.* 29 CFR 4.117(a) ("periodic and routine maintenance, preservation, care, adjustment, upkeep, or servicing of equipment to keep it in usable, serviceable, working order" is covered by the SCA).[8] A survey of authorities indicates that basic maintenance, routine maintenance, standard O&M, simple and standard replacements of equipment and other property, minor repair work, and similar work are covered by the SCA and are not construction, alteration, or repair work under Davis-Bacon. "[R]epair or replacement of portions of [a] utility system to accomplish routine, day-to-day service or maintenance work" may be covered by the SCA but is not Davis-Bacon work. *K&M Maintenance Services, Inc.*, 1989 WL 241424 at *2

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[6] *See, e.g.*, Field Operations Handbook, *supra* fn.3, sec. 15d13(a) (citing the SCA regulations at 29 CFR 4.116(c)(2)).

[7] *See id.*, sec. 15d13(c).

[8] *See also Chicago Rigging Co. v. Uniroyal Chemical Co.*, 718 F. Supp. 696 (1989); Comp. Gen. Opins. *RG&B Contractors, Inc.*, 1987 WL 101560 (Mar. 10, 1987); *Dynalectron Corporation*, 1986 WL 60708 (Feb. 11, 1986); *Yamas Constr. Co.*, 1985 WL 52802 (May 24, 1985).

(Nov. 21, 1989). Repair activity that is more in the nature of "servicing and maintenance work," rather than "construction activity," is not considered Davis-Bacon work. *See, e.g.*, *ITT Base Services, Inc., et al.*, 1986 WL 64288 at *4 (Nov. 10, 1986). This includes "routine, day-to-day work to extend the life of an item, system, or component," which is considered SCA work and not Davis-Bacon work. *Id.* On the other hand, "major work involving modifications to upgrade a facility, use new technology, standardize components, or expand capacity" is considered Davis-Bacon work. *Id.* Other Davis-Bacon work may include such things as "installation of components not previously existing, relocation of facilities, and extension of utility systems," as well as repairing major damage or failure of property or equipment. *Id.* (internal quotations omitted). In general, "alteration or repair" under Davis-Bacon refers to "construction-type" or "construction-like" activity.

The tax law applies similar definitions in the context of "incidental repairs" versus capital improvements. Under § 162 and Treas. Reg. § 1.162-4, taxpayers are allowed a deduction for ordinary and necessary trade or business expenses, including for "amounts paid for repairs and maintenance to tangible property if the amounts paid are not otherwise required to be capitalized." This regulation has traditionally applied to the cost of "incidental repairs that neither materially add to the value of the property nor appreciably prolong its useful life, but keep it in an ordinarily efficient operating condition." Rev. Rul. 2001-4, 2001-1 CB 295, 297. On the other hand, capitalization of costs has traditionally been required where repairs are "in the nature of replacements that arrest deterioration and appreciably prolong the life of the property." *Id.* Treas. Reg. § 1.263(a)-3 includes detailed rules to determine whether amounts are paid to improve tangible property and addresses "routine maintenance," which is deemed not to improve a unit of property (i.e., requiring capitalization). This regulation provides, in part:

> Routine maintenance for property other than buildings is the recurring activities that a taxpayer expects to perform as a result of the taxpayer's use of the unit of property to keep the unit of property in its ordinarily efficient operating condition. Routine maintenance activities include, for example, the inspection, cleaning, and testing of the unit of property, and the replacement of damaged or worn parts of the unit of property with comparable and commercially available replacement parts. ... Factors to be considered in determining whether maintenance is routine and whether the taxpayer's expectation is reasonable include the recurring nature of the activity, industry practice, manufacturers' recommendations, and the taxpayer's experience with similar or identical property.

Treas. Reg. § 1.263(a)-3(i)(1)(ii). Thus, the Davis-Bacon authorities on "construction, alteration, or repair" are well-aligned with the longstanding tax rules on the treatment of incidental repairs and maintenance. Both areas of law recognize a difference between incidental, recurring, and routine maintenance and repairs versus major repairs, replacements of major components, and substantial structural changes to property. The Guidance should adopt these same authorities to define what is "construction, alteration, or repair." It is important that the Guidance specifically define these terms because § 45(b)(7)(A)(ii) applies alteration or repair to the full 10-year PTC period for the qualified facility and § 48(a)(10)(A)(ii) applies alteration or repair to the 5-year period after the placed-in-service date of the energy project. Taxpayers are uncertain as to how these terms might be applied in the absence of such guidance.

Importantly, the application of an "alteration or repair" to a qualified facility or energy project, after construction is completed, should be a rare occurrence. Consistent with the Davis-Bacon and SCA authorities, the Guidance should recognize that basic maintenance, routine maintenance, standard O&M, simple and standard replacements of equipment and other property, minor repair work, and similar work are not treated as "construction, alteration, or repair" work under the PWA requirements in § 45(b)(7) and § 48(a)(10) (as well as other provisions applying the PWA requirements). For example, work performed by welders, winders, or machinists to address a customer service outage should *not* be treated as alteration or repair work under the PWA requirements.

Because of the uncertain application of "alteration or repair" during the 10-year PTC or 5-year ITC period, and in recognition of the limited scope of those terms, the Guidance should provide a *de minimis* threshold under which any alteration or repair work on a qualified facility or energy project will not require prevailing wage rates to be paid if the total amount paid by the taxpayer for such work is less than the greater of (i) $1,000,000, or (ii) 10% of the original capitalized cost of the qualified facility or energy project at the time it is originally placed in service. For this purpose, the original capitalized cost means the cost basis of such qualified facility or energy project under § 1012, unreduced by any other adjustment to basis (e.g., depreciation) under § 1016, and includes all items properly included by the taxpayer in the depreciable basis of such facility or project. For offshore wind qualified facilities or energy projects, which by nature and scale require more significant expense, alteration or repair work on a qualified facility or energy project should not require prevailing wages to be paid if such work does not alter the form, fit, or function of the turbine.

Consistent with Notice 2022-51, sec. 3.01(4), 2022-43 IRB 331, the Guidance should clarify that the payment of prevailing wages applies only to the construction period and specifically to any alteration or repair work, *if any*, that may occur during the 10-year PTC period or 5-year ITC period. That is, the Guidance should confirm that prevailing wages do *not* have to be paid, after the qualified facility or energy project has been placed in service, if *no alteration or repair work* occurs during the 10-year PTC period or 5-year ITC period, respectively. Likewise, the Guidance should confirm that prevailing wages do *not apply* to any taxable year after the 10-year PTC period ends or after the 5-year ITC period ends.

Requested Guidance: The Guidance should define "construction, alteration, or repair" consistent with the Davis-Bacon regulations, as summarized above:

- The phrase "construction, alteration, or repair," as used in the statute, applies only to work performed at the project site.

- The transportation of materials or supplies to or from the site of the work by employees of the construction contractor or subcontractor is not construction, alteration, or repair.

- The phrase "construction, alteration, or repair" is intended to cover construction activity, as distinguished from manufacturing, furnishing of materials, or servicing and maintenance work.

- Application of the prevailing wage requirements to alteration or repair, after the qualified

facility or energy project has been placed in service, should be limited in scope. Guidance should define "construction, alteration, or repair" consistent with the tax law rules related to "incidental repairs" and "routine maintenance." Further, Guidance should adopt a *de minimis* threshold under which any alteration or repair work on a qualified facility or energy project will not require prevailing wages to be paid if the total amount paid by the taxpayer for such work is less than the greater of (i) $1,000,000, or (ii) 10% of the original capitalized cost (as defined above) of the qualified facility or energy project at the time it is originally placed in service. For offshore wind qualified facilities or energy projects, which by nature and scale require more significant expense, alteration or repair work on a qualified facility or energy project should not require prevailing wages to be paid if such work does not alter the form, fit, or function of the turbine.

- The Guidance should clarify that "construction, alteration, or repair" generally does not apply to supply or service contracts (including installation work), offsite manufacturing work, preconstruction development work, and any other work that is incidental to the construction work at the site or *de minimis* in nature.

- The Guidance should confirm that all offsite and *de minimis* onsite transportation work is not covered by the PWA requirements.

- The Guidance should confirm that the prevailing wage requirement applies only to the construction period, through the placed-in-service date, of the qualified facility and only to any alteration or repair work that actually occurs during the 10-year PTC period or the 5-year ITC period, after the placed-in-service date of the qualified facility or energy project. If no alteration or repair work occurs, no prevailing wages are required to be paid during the 10-year PTC period or 5-year ITC period. The prevailing wage requirement has no application after the 10-year PTC period or 5-year ITC period.

D. Site of the Work. As discussed above, under Davis-Bacon, the application of the prevailing wage requirement is limited to the "site of the work," which is defined, generally, as:

> the physical place or places where the building or work called for in the contract will remain; and any other site where a significant portion of the building or work is constructed, provided that such site is established specifically for the performance of the contract or project.

29 CFR 5.2(l)(1). Job headquarters, tool yards, batch plants, borrow pits, and similar locations are treated as part of the site of the work – provided that "they are dedicated exclusively, or nearly so, to performance of the contract or project, and provided they are adjacent or virtually adjacent to the site of the work as defined" above. 29 CFR 5.2(l)(2). Permanent home offices, branch plant establishments, fabrication plants, tool yards, and similar locations of a contractor or subcontractor "whose location and continuance in operation are determined wholly without regard to a particular Federal or federally assisted contract or project" are not included in the definition of the "site of the work." 29 CFR 5.2(l)(3). Also, offsite facilities established by any supplier of materials *before opening of bids* are not included in the definition of the "site of the work," even if dedicated to the project for any period of time. *Id.*

Under § 45(b)(7) and (8), "construction, alteration, or repair" specifically references the "qualified facility," which the tax law has defined narrowly under § 45 (*see, e.g.*, Rev. Rul. 94-31, 1994-1 CB 16), and does not reference potentially broader terms such as the "site of the work" or "project."[9] It is not clear under § 45(b)(7) and (8), in light of the IRA's reference to Davis-Bacon, whether the PWA requirements are limited to the qualified facility itself or extend to the project site. The Guidance should clarify this issue under § 45 and with respect to other tax credits that reference the qualified facility. The Guidance should also clarify the IRA's scope with respect to the ITC, which applies more broadly to the "energy project." *See* § 48(a)(10). See GE Briefing Paper on the Domestic Content Bonus regarding the definition of the respective terms "qualified facility" and "energy project" under §§ 45, 45Y, 48, and 48E. In any event, the Guidance should confirm that the scope of the PWA requirements is no broader than the relatively limited scope of Davis-Bacon, as confirmed by the case law, as applying only to those laborers or mechanics employed *directly upon the site of the work*.

Requested Guidance: The Guidance should confirm and/or clarify the following matters regarding the "site of the work" and geographical scope of the PWA requirements:

- Clarify the scope of the PWA requirements under § 45 with respect to the PTC and whether those requirements apply only to the qualified facility itself or extend to other areas of the project site (e.g., access roads, substations, buildings, etc.).

- Clarify the scope of the PWA requirements under § 48 with respect to the ITC and the broader "energy project." The PWA requirements should not extend beyond the energy properties included in the energy project.

- Clarify that the PWA requirements should extend no further than the "site of the work," which in any case should not extend beyond the immediate boundaries of the project construction site for the qualified facility or energy project, as the case may be.

- Confirm that the PWA requirements apply only to laborers or mechanics employed directly upon the work site. Secondary sites, in the case of a qualified wind facility, should be limited to only those sites that are adjacent to the wind turbine locations and should not extend to offsite areas except in exceptional circumstances.

- Confirm that transient workers who travel from project to project or to offsite headquarters or branch locations are only required to be paid at prevailing wage rates for their time on the site of the work and adopt a *de minimis* standard to exempt employees who spend insignificant time onsite.

E. Determination of the Prevailing Wage Rate

Under Davis-Bacon, the term "prevailing wage" means "the wage paid to the majority (more than 50 percent) of the laborers or mechanics in the classification on similar projects in the area during the period in question. If the same wage is not paid to a majority of those employed

[9] During the Senate amendment process, references to the "applicable project" under I.R.C. § 45(b)(8), for example, were in fact changed to "qualified facility."

in the classification, the prevailing wage shall be the average of the wages paid, weighted by the total employed in the classification." 29 CFR 1.2(a)(1). The term "area," for purposes of making wage determinations, is normally the county. 29 CFR 1.7(a).[10] The Administrator of the Wage and Hour Division at DOL issues a "wage determination," which lists the prevailing wage rates and fringe benefit rates for each classification of laborers and mechanics in a given area for a particular type of construction. The wage rates and fringe benefits in the applicable wage determination are the wages required to be paid to laborers and mechanics.[11]

There are two types of wage determinations: general determinations and project-specific determinations. General wage determinations are published at https://sam.gov/content/wage-determinations for contracting agencies to incorporate into covered contracts. If a general wage determination is not available, a project-specific determination may be obtained by submitting a Form SF-308 (Request for Wage Determination and Response to Request) as outlined in 29 CFR 1.5(b).[12] Wage determinations are classified by the type of construction, i.e., building, heavy, highway, or residential. Guidance on determining the type of construction is provided in All Agency Memoranda ("AAM") Nos. 130, 131, and 236.[13] Under these AAMs, a single wage determination generally applies to a particular construction project, and "incidental" activities are disregarded (i.e., closely related in function to the main activity). Multiple classifications may be justified if certain construction items are a substantial part of the project; i.e., when work in a different category exceeds either $2.5 million or 20% of costs, a contracting agency would generally apply the wage determination for the different category in addition to the wage determination for the overall project. Based on the AAMs, a qualified wind facility and other qualified facilities and energy projects likely would be classified under the "heavy" category with respect to the overall project but may also include multiple classifications for "highway" and "building" with respect to certain work at the project construction site.

Section 45(b)(7)(A) and § 48(a)(10)(A) use the phrase "similar character in the locality" for purposes of the prevailing wage rate. Those terms are similar to the standards used to determine the particular type of construction under Davis-Bacon for prevailing wage determinations. It is not clear that Congress intended that any different meaning apply on the basis of this language.

The Guidance should specifically address projects that span multiple localities. For example, large-scale wind energy projects may be located in multiple counties. These projects are often located in areas where the specific boundary lines are not delineated. It may prove to be difficult, in these circumstances, to track specific time spent by laborers or mechanics in the specific geographic jurisdictions on a project-wide basis. The Guidance should adopt rules that provide flexibility for projects in these circumstances. The Guidance should permit project sponsors, taxpayers, contractors, or subcontractors to adopt reasonable methods for applying a

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[10] The Davis-Bacon regulations provide for different methods of making wage determinations when current wage data is insufficient at the county level or other levels. *See* 29 CFR 1.7(b), (c).

[11] *See* Frequently Asked Questions ("FAQs"), *available at* https://www.dol.gov/agencies/whd/government-contracts/construction/faq. The terms "wages," "prevailing wages," and the types of fringe benefits included in wage determinations are defined in 40 USC 3141(2) and 29 CFR 5.2(q).

[12] *See* FAQs, *supra* fn. 11, Q&A-8.

[13] *See* DOL Fact Sheet #66, *available at* https://www.dol.gov/sites/dolgov/files/WHD/legacy/files/whdfs66.pdf. The above AAMs are *available at* https://sam.gov/content/wage-determinations/resources/all-agency-memos.

single set of prevailing wage rates for the project. The Guidance also should permit project sponsors or owners to seek a project-level determination from the DOL and permit taxpayers, contractors, and subcontractors to rely on the project-level determination without having to track time spent at specific geographic locations within the project construction site.

It is worth emphasizing that the construction of a qualified facility or energy project may be subject to a Project Labor Agreement ("PLA") or other collective bargaining agreement with one or more labor organizations. In those circumstances, the PLA will establish the terms and conditions of employment at the project site, including the proper wage rates for laborers and mechanics that might otherwise be covered by Davis-Bacon. The PLA applies to construction contractors and subcontractors for the project. The taxpayer, contractors, and subcontractors for the project should not be required to pay prevailing wages and should be deemed to satisfy the prevailing wage requirements if the construction, alteration, or repair of the qualified facility or energy project is governed by a PLA or similar collective bargaining agreement.

Requested Guidance: Taxpayers, including all project stakeholders, require clarity in the application of prevailing wage rates. The IRA does not provide specific guidance regarding how the prevailing wage rate is determined and refers to the Secretary as the party making the "final determination" on prevailing wages. Specifically:

- The Guidance should provide a process to provide certainty to taxpayers, contractors, and subcontractors with respect to the wage determination and the construction classification of qualified facilities and energy projects (e.g., "heavy" at the overall project level), including the circumstances wherein multiple wage classifications may be required.

- Taxpayers, contractors, and subcontractors should have the ability to rely on the same DOL general determinations (by county or other area) as contracting agencies and also should have the opportunity to submit Form SF-308 (or similar form) to DOL for a project-specific wage determination.

- The Guidance should specifically address situations in which the project construction site is located in multiple counties or localities and adopt flexible rules to eliminate the need for taxpayers, contractors, and subcontractors to track specific time spent in different geographic jurisdictions.

- Taxpayers, contractors, and subcontractors who rely on wage determinations – general or project-specific – from DOL should be deemed to satisfy the PWA requirements.

- Guidance should provide that taxpayers, contractors, or subcontractors will be deemed to be in compliance with the PWA requirements in the case of PLAs or similar collective bargaining agreements that provide for negotiated non-standard wage rates. Such labor contracts preclude paying workers a different amount from the agreed rates.

F. Application of the Curative Payment and Penalty Rules

Both the prevailing wage and apprenticeship requirements allow taxpayers to cure any failure to satisfy one or both of those requirements, but the statute introduces practical issues in

the context of the traditional timing of the taxpayer taking ownership of the qualified facility (at or near substantial completion), the fact that the taxpayer may not be the party that contracts with contractors during the construction phase, and the fact that the Davis-Bacon prevailing wage rate is typically applied and enforced at the contractor and subcontractor levels. Likewise, the use of qualified apprentices during the construction phase, in most cases, will be controlled by the contractors and subcontractors engaged on the project. In addition, the "final determination" by the "Secretary" under § 45(b)(7)(B)(iv), for prevailing wage purposes, may not occur until after the construction, alteration, or repair work has been completed, and the contractors and subcontractors, as well as the affected employee laborers or mechanics, have left the site. The statute requires that the curative payments be made to the affected laborers or mechanics, and provides a 180-day period to make such payments, but does not provide any guidance for situations where the laborers or mechanics cannot be found or otherwise paid. The statute does not address these practical issues presented under the curative payment provisions.

Section 45(b)(7)(B)(ii) provides that deficiency procedures do not apply to the penalty and § 45(b)(7)(B)(iv) refers to "a final determination by the Secretary" with respect to the payment of prevailing wages. The statute does not provide any further procedures for the taxpayer to challenge or appeal this final determination and otherwise to seek relief from any penalty that may be imposed. Taxpayers should have the opportunity to challenge or appeal determinations and penalties that they believe are incorrect.

Under Davis-Bacon, contractors and subcontractors are permitted to hire apprentices at wage rates less than the prevailing wage for the work performed. 29 CFR 5.5(a)(4)(i). In order to do so, the apprentices must be registered under a DOL or State apprenticeship agency program – consistent with the definition of "qualified apprentice" under § 45(b)(8)(E)(ii). Because of the potential avoidance of prevailing wage rates, however, registered apprenticeship programs may impose an allowable ratio of apprentices to journeyworkers. *See* 29 CFR 5.5(a)(4)(i). Section 45(b)(8)(B) references the apprentice-to-journeyworker ratio requirements, but does not provide any further guidance on the application of those ratios. In addition, the curative payment provision under the apprenticeship requirement does not provide any guidance on addressing a circumstance where the taxpayer, contractor, or subcontractor inadvertently exceeds a prescribed ratio. Taxpayers require guidance on this limitation and application of the curative payment and good faith effort requirements in these circumstances.

Section 45(b)(8)(D)(ii) deems the apprenticeship requirement as satisfied if the taxpayer makes a good faith effort to satisfy the labor hours requirement in § 45(b)(8)(A) and the participation requirement in § 45(b)(8)(C). In general, the taxpayer's good faith effort is shown if the taxpayer has requested qualified apprentices from a registered apprenticeship program and the request is either denied or the program fails to timely respond to the taxpayer's request. § 45(b)(8)(D)(ii). However, in the case of a denial, § 45(b)(8)(D)(ii)(I) clarifies that the denial may not be "the result of a refusal by the taxpayer or any contractors or subcontractors engaged in the performance of construction, alteration, or repair work with respect to such qualified facility to comply with the established standards and requirements of the registered apprenticeship program."

The Guidance should clarify two issues with respect to the good faith effort exception. First, the Guidance should recognize that the taxpayer may not be the party that makes the request to the registered apprenticeship program, but rather the taxpayer may not be involved in the construction phase of the project and may need to rely on the representations of the project sponsor and its contractors and subcontractors that the proper request was made and compliance with the established standards and requirements of the apprenticeship program were followed. The Guidance should permit the taxpayer to rely in good faith, after conducting reasonable due diligence, on the representations of the project sponsor and any contractors or subcontractors. Second, the Guidance should evaluate whether the taxpayer has made a good faith effort, both in making its request to a registered apprenticeship program and in conducting its due diligence of contractors and subcontractors, by reference to other sections of the Code that reference good faith efforts on behalf of the taxpayer. For example, the Guidance should adopt standards similar to those applied in Treas. Reg. § 1.6664-4(b) and (c) with respect to accuracy-related penalties.

The statute also increases the applicable payments and penalties under the curative payment provisions under both PWA requirements for "intentional disregard," but does not define that term and the precise party (taxpayer, contractor, or subcontractor) to which it applies. In the context of accuracy-related penalties under § 6662, the term is applied where "the taxpayer knows of the rule or regulation that is disregarded," but can avoid the penalty "if the contrary position has a realistic possibility of being sustained on its merits." Treas. Reg. § 1.6662-3(b)(2). In the context of civil penalties imposed under § 6721(e), for incorrect information returns, "a failure is due to 'intentional disregard' if it is []'knowing or willful'" – determined on the basis of all the facts and circumstances in the particular case. Treas. Reg. § 301.6721-1(f)(2). Relevant facts and circumstances include whether the failure is part of a pattern of conduct by the person who filed the return and whether correction was promptly made upon discovery of the failure. Treas. Reg. § 301.6721-1(f)(3).

Requested Guidance: The Guidance should confirm and/or clarify the following matters with respect to the curative payment and penalty rules for the PWA requirements:

- Confirm that if the taxpayer (or contractor or subcontractor) timely cures any deficiency in wages paid to any laborer or mechanic for work performed prior to completion of construction and pays the proper penalty amount that the prevailing wage requirement shall be deemed to be satisfied and the full rate shall apply for the 10-year PTC period.

- In the case of any failure to pay prevailing wage rates with respect to any alteration or repair work, the Guidance should clarify that any reduction in the PTC rate applies only to the specific period during which the failure to pay the prevailing wage rate occurred and has not been cured by making the required payments, and such reduction should not be applied retroactively to disallow PTCs that have already accrued during prior periods and taxable years.

- The Guidance should clarify the process for making a "final determination" and address specifically the issue of laborers or mechanics who cannot be located timely for purposes of making the curative payments. For example, the Guidance may provide for payment

of amounts into an escrow account,[14] deposit to the IRS, or good faith effort requirements to allow taxpayers to satisfy the curative payment rules in these circumstances.

- The Guidance should provide taxpayers with the opportunity to challenge or appeal any finding of a failure to pay a prevailing wage rate prior to any "final determination." With respect to the apprenticeship requirement, if any apprentice-to-journeyworker ratio requirement is exceeded, the taxpayer should have an opportunity to cure by paying the proper amount of prevailing wages to the affected apprentices.[15]

- The Guidance should specifically address the good faith effort exception in § 45(b)(8)(D)(ii) and permit the taxpayer to rely on representations made by the project sponsor, contractors, and subcontractors that appropriate requests were made to a registered apprenticeship program. The Guidance should evaluate the taxpayer's good faith efforts by reference to other sections of the Code, including § 6664 and Treas. Reg. § 1.6664-4(b) and (c).

- Finally, the Guidance should define the term "intentional disregard," and the specific circumstances in which it applies, consistent with other Code provisions to mean a knowing and willful disregard of the applicable PWA requirements.

G. Apprenticeship Requirement Applicable Only to Construction Period

Section 45(b)(8) commences by stating that "[t]he requirements described in this paragraph with respect to the construction of any qualified facility are as follows...." Similarly, § 45(b)(8)(A) commences by stating that "[t]axpayers shall ensure that, with respect to the construction of any qualified facility...." Finally, § 45(b)(8)(C) provides that "[e]ach taxpayer, contractor, or subcontractor who employs 4 or more individuals to perform construction, alteration, or repair work *with respect to the construction of a qualified facility* shall employ 1 or more qualified apprentices to perform such work." Section 45(b)(8) does not include any provision similar to § 45(b)(7)(A)(ii) or 48(a)(10)(ii) with respect to alteration or repair work occurring during the 10-year PTC period or 5-year ITC period, respectively, after the placed-in-service date of the qualified facility or energy project.

Requested Guidance: The Guidance should confirm that the apprenticeship requirement applies only to the construction of the qualified facility or energy project, as the case may be, and does not apply to any period after the qualified facility or energy project is placed in service.

H. Confirmation when PWA Standards Do Not Apply

Under § 45(b)(6)(B), the full PTC rate applies if "one of the following" listed requirements are met – including "[a] facility the construction of which begins prior to the date that is 60 days after the Secretary publishes guidance with respect to the requirements of [§ 45(b)(7)(A) and (8)]." The satisfaction of the PWA requirements represents a separate way to

[14] *Cf.* U.S. Department of Housing and Urban Development, Handbook 1344.1 Rev 2, at sec. 5.10(I), 5-17 (Feb. 2012) (notion of a "labor standards escrow account" for unfound or unpaid employees).
[15] *See, e.g.*, Field Operation Handbook, *supra* fn. 3, sec. 15e01(c).

achieve the increased credit amount and realizing the full PTC rate under § 45(b)(6)(B). Likewise, under § 48(a)(9)(B), similar rules apply to determine whether the full ITC rate of 30% applies.[16]

Requested Guidance: The Guidance should confirm that under § 45(b)(6)(A) and (B), when read together, a qualified facility is deemed to meet the requirements of § 45(b)(6)(A) – i.e., with respect to the increased credit amount – if it is a facility the construction of which begins prior to the date that is 60 days after the Secretary publishes guidance with respect to the PWA requirements. If this requirement is satisfied, then satisfaction of either the prevailing wage rate or the apprenticeship requirement is not required. The same conclusion should apply to the ITC under § 48(a)(9)(A) and (B), which reflect similar rules for determining the increased ITC rate.

* * *

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[16] As noted in the Background section, § 45V(e)(2) applies a different rule with respect to a qualified clean hydrogen production facility. Under § 45V(e)(2), the increased credit amount applies if construction on the facility begins prior to the date that is 60 days after the publication of the PWA guidance. However, unlike § 45(b)(6)(B), § 45V(e)(2) provides that the prevailing wage requirement must still be satisfied for any alteration or repair work on the facility after that date.

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Domestic Content Bonus

November 4, 2022

The Inflation Reduction Act of 2022, Pub. L. No. 117-169 ("IRA"), extended the production tax credit ("PTC") for qualified facilities under § 45 of the Internal Revenue Code ("Code"),[1] and the investment tax credit ("ITC") for certain types of energy property under § 48 of the Code. The § 45 PTC and § 48 ITC phase out for facilities and projects that begin construction after 2024; however, the IRA provides a new PTC under § 45Y and an ITC under § 48E that replace these credits. In addition, the IRA provides increased credit amounts and bonuses, including a domestic content bonus for qualified facilities and energy projects placed in service after December 31, 2022. Taxpayers require guidance on the application of the domestic content bonus to qualified facilities and energy projects, including (i) application of the Buy America Act rules under 49 CFR 661, (ii) the definition of qualified facility and energy project for domestic content purposes with respect to §§ 45, 48, 45Y, and 48E, (iii) steel and iron requirements, (iv) identity of manufactured products and what constitutes manufacturing in the United States, and (v) determination of the total costs of manufactured products to determine domestic content (these issues are described together as the "Guidance").

Background

The IRA provides a domestic content bonus for any § 45 qualified facility of 10% of the credit amount otherwise available for the PTC. § 45(b)(9)(A). The full value of the domestic content bonus is available if the taxpayer also satisfies the prevailing wage and apprenticeship rules. For example, the full PTC rate for wind facilities placed in service after December 31, 2021 is $27.50 per megawatt hour ("MWh"). The domestic content bonus will increase the full PTC rate to $30.25 per MWh. Section 45Y provides similar domestic content rules as § 45(b)(9)(B) for the PTC for qualified facilities placed in service after December 31, 2024. § 45Y(g)(11)(B).

The IRA also provides a domestic content bonus for a § 48 energy project which satisfies the domestic content requirements. § 48(a)(12)(A). The domestic content requirements for an energy project are based on "[r]ules similar to the rules of section 45(b)(9)(B)." § 48(a)(12)(B). The full value of the domestic content bonus is available if the taxpayer also satisfies the prevailing wage and apprenticeship rules. For example, the full ITC rate for energy projects placed in service after December 31, 2021 is 30% of eligible basis. The domestic content bonus will increase the full ITC rate by 10 percentage points to 40% of eligible basis. § 48(a)(12)(C)(ii). Section 48E provides similar domestic content rules as § 48(a)(12) for qualified facilities placed in service after December 31, 2024. § 48E(a)(3)(B).

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[1] All Section (§) references to the Code are as amended by the Inflation Reduction Act of 2022, Pub. L. No. 117-169.

The domestic content requirement is satisfied:

> with respect to any qualified facility if the taxpayer certifies to the Secretary (at such time, and in such form and manner, as the Secretary may prescribe) that any steel, iron, or manufactured product which is a component of such facility (upon completion of construction) was produced in the United States *(as determined under section 661 of title 49, Code of Federal Regulations).* [Emphasis added.]

§ 45(b)(9)(B)(i). In the case of steel or iron, this requirement is applied in "a manner consistent with section 661.5 of title 49, Code of Federal Regulations." § 45(b)(9)(B)(ii). In the case of a manufactured product, § 45(b)(9)(B)(iii) provides:

> For purposes of clause (i), the manufactured products which are components of a qualified facility upon completion of construction shall be deemed to have been produced in the United States if not less than the adjusted percentage…of the total costs of all such manufactured products of such facility are attributable to manufactured products (including components) which are mined, produced, or manufactured in the United States.

For purposes of §§ 45, 48, and 48E, the "adjusted percentage" for qualified facilities and energy projects is 40% (and 20% for offshore wind). *See, e.g.,* § 45(b)(9)(C). For purposes of the § 45Y credit, the adjusted percentages increase up to 55%, depending on when construction of the qualified facility begins. *See* § 45Y(g)(11)(C). We note that § 45Y ramps up the applicable percentage from 40% to 55% depending on when construction begins. One would expect that the corresponding § 48E rules would ramp up in a similar fashion; however, § 48E specifically cross-references § 48(a)(12), which cross-references § 45(b)(9)(B), which does not include a ramp-up. This difference may be a statutory error or Treasury might conform the two sections based on the statutory requirement that "rules similar" are to apply to each section, which are intended to follow from the currently effective sections. Further support for applying the ramp-up to § 48E is based on the fact that § 48E(d)(5) (the domestic content requirement for elective payment) provides "rules similar to the rules of section 45Y(g)(12) shall apply." This shows an intent for § 48E and § 45Y to be interpreted in a similar way as it relates to domestic content.

It also is worth noting from the above statutory language that all steel or iron must be "produced" in the United States and that the applicable percentage of all "manufactured products" must be "mined, produced, or manufactured in the United States." The term "mining" is not relevant to the types of manufactured products which are components of a qualified facility or energy project, which is the subject matter of this briefing paper. In the case of a manufactured product which is a component of a qualified facility being "produced or manufactured" in the United States, we believe the words produce and manufacture are synonymous because a manufactured product must undergo a "manufacturing process" under the applicable rules as discussed below.

Discussion

A. <u>Application of Buy America Act Rules</u>. As the above statutory language denotes, the determination of domestic content is required to be made under the Buy America Act ("BAA") regulations, section 661 of title 49, Code of Federal Regulations, which apply generally to federally-funded transportation projects. The BAA, first enacted in 1978, includes well-established rules in the regulations and substantial guidance in the form of rulings from the Federal Transit Administration ("FTA") interpreting those rules. The regulations, guidance, and rulings promulgated by the FTA with regard to the BAA requirements present a very clear analogue for Treasury and the IRS in interpreting the domestic content requirements in § 45(b)(9)(B).

Requested Guidance. Guidance under § 45(b)(9)(B) should follow Congress' expressed intent that domestic content requirements for steel, iron and manufactured products that are a component of a qualified facility are determined in a manner consistent with the BAA rules of section 661 of title 49, Code of Federal Regulations. Note that the application of the BAA rules for domestic content is specific to determining whether steel, iron and manufactured products are produced or manufactured in the United States and is <u>not</u> a wholesale importation of 661 of title 49 as it applies to certifications, waivers, rolling stock, and certain other provisions of that section.

B. <u>Qualified Facility and Energy Property for Domestic Content Purposes</u>. The scope of property to which the domestic content requirements apply will necessarily vary based on whether the property is a "qualified facility" under § 45 or an "energy project" under § 48. Similarly, the scope of property to which the domestic content requirements applies will necessarily vary between §§ 45Y and 48E.

Under IRC § 45(b)(9)(B)(i), domestic content applies to "any steel, iron, or manufactured product which is a component of such *qualified facility*...." (Emphasis added.) The term "qualified facility" is generally limited to the assets necessary to the production of electricity in the case of § 45. For example, the term "qualified facility" has a settled meaning with respect to a wind facility. Rev. Rul. 94-31, 1994-1 CB 16, is clear that the property comprising the "facility" is quite narrow. Rev. Rul. 94-31 ruled that "each wind turbine together with its tower and supporting pad . . . is a separate facility" and "[e]ach of these facilities is a qualified facility. . . ." Rev. Rul. 94-31 explains:

> A wind turbine together with its tower and supporting pad comprise *the property on the windfarm necessary for the production of electricity from wind energy*. Moreover, each wind turbine on the windfarm can be separately operated and metered and can begin producing electricity when it is mounted atop a tower. Thus, the term "facility" under section 45(c)(3) means the wind turbine, together with the tower on which the wind turbine is mounted and the pad on which the tower is situated. [Emphasis added.]

Rev. Rul. 94-31 expressly defines the components and property that comprise the "facility" for purposes of § 45(d)(1). Rev. Rul. 94-31 also specifically lists in the fact section the property, including balance of plant, that makes up the windfarm. This property includes transformers,

roadways, fencing, on-site power collection systems, and monitoring and meteorological equipment. However, the ruling section defines the "facility" narrowly to include only the specific components noted above – i.e., the wind turbine together with its tower and supporting pad – and omits the other windfarm property from the definition of qualified facility.

In ILM 200347024 (Jan. 21, 2003), the IRS Office of Chief Counsel expounded on Rev. Rul. 94-31 and the definition of the "facility." The memorandum describes Rev. Rul. 94-31 as follows:

> Rev. Rul. 94-31, 1994-1 C.B. 16, provides the Service's published position on what is a qualified facility for purposes of § 45(c)(3) (an analogous provision to § 29-both provisions are production credits as distinguished from the § 48(l) energy credit, which was an investment credit). This revenue ruling addresses a wind farm used to generate electricity from wind energy. While noting the array of equipment used to operate the wind farm and deliver the final product, the revenue ruling concludes, in part, that the term "facility" under § 45(c)(3) means the wind turbine (which includes blades, gear box, generator and a control and a communication mechanism), together with the tower on which the wind turbine is mounted and the pad on which the tower is situated. The revenue ruling further concludes that each wind turbine together with its tower and supporting pad is a separate facility. *This definition is quite narrow, excluding from the term facility support and delivery assets such as transformers, on-site power collection systems, monitoring and meteorological equipment, and site improvements such as roadways and fencing. While the entire wind farm may be an integrated generating plant, for purposes of the energy credit, a turbine, a tower, and a pad constituted a facility*. [Emphasis added.]

Tracking the emphasized language from the Chief Counsel memorandum above, the IRS has ruled in the context of a wind facility that "[t]his definition [of the facility] is quite narrow, excluding from the term facility support and delivery assets such as transformers, on-site power collection systems, monitoring and meteorological equipment, and site improvements such as roadways and fencing." PLR 201205005 (Nov. 3, 2011) (determining placed-in-service date for wind turbines and analyzing Rev. Rul. 94-31 in context of defining a facility). Thus, under Rev. Rul. 94-31, the "qualified facility" is the wind turbine together with its tower and supporting pad, which is the property on the windfarm necessary for the production of electricity from wind energy and excludes support and delivery assets.

The IRS has similarly narrowly defined other types of qualified facilities for purposes of § 45. In Notice 2006-88, 2006-2 CB 686, the IRS defined the "qualified facility" for production of electricity from open-loop biomass as follows:

> For purposes of § 45(d)(3), an open-loop biomass facility is a power plant consisting of *all components necessary for the production of electricity from open-loop biomass (and, if applicable, other energy sources)*. Thus, a qualified open-loop biomass facility includes all burners and boilers (whether or not burning open-loop biomass), any handling and delivery equipment that supplies fuel directly to and is integrated with such burners and boilers, steam headers,

> turbines, generators, and all other depreciable property necessary to the production of electricity. *The facility does not include (i) property used for the collection, processing, or storage of open-loop biomass before its use in the production of electricity, (ii) transformers or other property used in the transmission of electricity after its production, or (iii) ancillary site improvements, such as roadways and fencing, that are not necessary to the production of electricity*. Each power plant that is operated as a separate integrated unit is treated as a separate facility for purposes of § 45(d)(3).

Notice 2006-88, sec. 3.01 (emphasis added).

The "qualified facility" for purposes of the domestic content bonus credit should be defined consistent with the established definition of such facilities for purposes of § 45. In the case of a wind project, the qualified facility for purposes of the domestic content bonus is the wind turbine together with its tower and supporting pad. Other windfarm property is omitted from the definition of qualified facility and should not be considered for the domestic content bonus. In the case of other § 45 technologies, the qualified facility should be limited to the components necessary for the production of electricity from the resource and not include property used for the collection, processing, or storage of raw materials before its use in the production of electricity, transformers or other property used in the transmission of electricity after its production, or ancillary site improvements, such as roadways and fencing, that are not necessary to the production of electricity.

In contrast, the definition of "energy property" included in an energy project under § 48 is quite broad and includes all of the tangible personal property and other tangible property (excluding a building and its structural components) integral to the energy project. As noted above, the domestic content bonus for § 48 applies to an "energy project" based on "rules similar to the rules of section 45(b)(9)(B)." § 48(a)(12)(B). An "energy project" is defined in § 48(a)(9)(A)(ii) as follows: "the term 'energy project' means a project consisting of one or more energy properties that are part of a single project." Thus, the term "energy project" keys off the well-established term "energy property." The phrase "rules similar to the rules of section 45(b)(9)(B)" should apply to how domestic content is determined for energy projects under § 48, not the scope of property in a qualified facility versus an energy project, which differs based on well-established rules.

Section 48(a)(3) provides that "energy property" includes various types of energy systems such as solar electricity generation equipment, solar heating systems, geothermal systems, fuel cells, microturbines, etc. Further, § 45(a)(5) provides that certain § 45 qualified facilities can elect to be treated as "energy property" and claim ITC under § 48 in lieu of the PTC. This election for certain § 45 qualified facilities to be treated as "energy property" will likely be used for offshore wind, incremental hydropower, and possibly certain other types of § 45 facilities. In the case of an electing qualified facility, the term "qualified property" means property which is tangible personal property, or other tangible property (not including a building or its structural components), but only if such property is used as an integral part of the qualified investment credit facility with respect to which depreciation (or amortization in lieu of depreciation) is allowable, which is constructed, reconstructed, erected, or acquired by the taxpayer, and the original use of which commences with the taxpayer. § 48(a)(5)(D). This

definition of "qualified property" for purposes of an electing § 45 qualified facility tracks the definition of qualified energy property for other energy property under § 48. *See* Treas. Reg. § 1.48-1 (§ 38 property defined as tangible personal property or other tangible property (not including a building or its structural components), which is depreciable, and where such property is integral to the qualified activity, such as the production of electricity). In general, the eligible property only extends to the substation at which the electrical voltage is stepped up to transmission voltage. *See,* Treas. Reg. § 1.48-9(d)(3) ("solar energy property used to generate electricity includes only equipment up to (but not including) the stage that transmits or uses electricity."); CCA 201122018 (June 3, 2011) (designating which property associated with the substation at a wind farm is eligible property).

With regard to § 45Y, the above scope of "qualified facility" should continue to apply to the new credit. Section 45Y will provide a new ten-year technology-neutral PTC applicable to electricity produced by a taxpayer at a "qualified facility" placed in service after December 31, 2024, for which the greenhouse gas emissions rate is not greater than zero (a facility that meets the preceding requirements is a "qualified facility") and which electricity is sold to an unrelated person, or sold, consumed, or stored by the taxpayer (as long as the facility is equipped with a metering device that is owned and operated by an unrelated person). In the context of the § 45Y PTC, the defined term "qualified facility" should continue to have the same definition as for § 45 because the credit is based on the "production" of electricity by a facility which otherwise meets the other requirements of the section.

On the other hand, in the case of § 48E, the "qualified facility" is defined, most importantly, by reference to "qualified property," which definition tracks the well-established definition of ITC-eligible energy property for purposes of § 48. Section 48E(b)(3) provides, in relevant part, that the term "qualified facility" means a facility "(i) which is used for the generation of electricity, (ii) which is placed in service after December 31, 2024, and (iii) for which the anticipated greenhouse gas emissions rate…is not greater than zero." Section 48E(b)(2) provides the term "qualified property" means property "(A) which is—(i) tangible personal property, or (ii) other tangible property (not including a building or its structural components), but only if such property is used as an integral part of the qualified facility, (B) with respect to which depreciation (or amortization in lieu of depreciation) is allowable, and (C) …the original use of such property commences with the taxpayer." *Cf.* Treas. Reg. § 1.48-1. The § 48E credit thus follows the established definition of ITC-eligible property used for purposes of § 48. One distinction for purposes of § 48E is the scope of the property included in the qualified facility may extend past the substation, at which point the electricity is converted to transmission voltage, to qualified interconnection property in certain cases, i.e., 5 megawatt (MW) net capacity or less. *See* § 48E(b)(1)(B)(i). The scope of eligible property in a § 48E qualified facility should generally be defined consistent with the existing rules for energy property under § 48, except as noted above. Further, the statutory definition of "qualified facility" for purposes of § 48E, which tracks the established definition of energy property under § 48, indicates that such definition is intended to apply to the scope of property for § 48, rather than the more limited definition of qualified facility for purposes of § 45.

Requested Guidance. Guidance should confirm the following matters with respect to the scope of property for domestic content purposes:

- In determining the domestic content of a "qualified facility" under § 45 or "energy property" under § 48, the terms should be defined consistent with their well-established definitions. Thus, domestic content for a "qualified facility" under § 45 should be limited to the assets necessary to the production of electricity. In the case of a wind facility for purposes of § 45, the term "qualified facility" should be defined in the same manner as the definition in Rev. Rul. 94-31, i.e., each wind turbine together with its tower and supporting pad. Other items such as transformers, power collection systems, monitoring and meteorological equipment, the SCADA system, and site improvements (roadways and fencing) should not be treated as part of the "qualified facility" to determine domestic content. *See* Notice 2006-88, sec. 3.01, 2006-2 CB 686; ILM 200347024 (Jan. 21, 2003).

- In the case of an "energy project" or "energy property" under § 48, the Guidance should provide that the domestic content requirement should be determined based on the whole of the qualified investment credit property that constitute steel, iron or a manufactured product as those items are defined below. For energy property such as offshore wind or solar, this would generally include all of the assets included in the project up through the associated substation where the electricity is stepped-up to transmission voltage. It is important to note, of course, that certain property that qualifies for the ITC would not be taken into account because it is not steel, iron or a manufactured product, such as service roads, storm water management, drainage facilities, earthen or concrete pads, and similar onsite constructed items.

- In the case of §§ 45Y and 48E, the scope of the property to which the domestic content bonus applies should correspond to scope of property under §§ 45 and 48, respectively.

C. <u>Steel and Iron Requirements</u>. The statute specifically refers to 49 CFR 661.5 in applying the domestic content requirements to steel or iron, which provides, generally, that "[a]ll steel and iron manufacturing processes must take place in the United States...." 49 CFR 661.5(b). These requirements apply to:

> all construction materials made primarily of steel or iron and used in infrastructure projects such as transit or maintenance facilities, rail lines, and bridges. *These items include, but are not limited to, structural steel or iron, steel or iron beams and columns, running rail and contact rail. These requirements do not apply to steel or iron used as components or subcomponents of other manufactured products....*

49 CFR 661.5(c) (emphasis added). The BAA does not provide a specific percentage threshold for measuring whether construction materials are made *primarily* of steel or iron. *See* FTA Final Rule, Buy America Requirements, 61 Fed. Reg. 6299, 6300 (Feb. 16, 1996). Rather, the FTA

applies these requirements only to steel or iron that provides a structural, load-bearing, or support function.[2]

Under the BAA rules, the steel or iron requirements do not apply to steel or iron used as components or subcomponents of other manufactured products. 49 CFR 661.5(c). Rather, in those circumstances, the item is analyzed in the context of the manufactured products requirements under 49 CFR 661.5(d) (discussed in more detail below).[3]

Requested Guidance. Guidance should confirm and/or clarify the following matters with respect to steel or iron used in a qualified facility or energy project:

- Consistent with FTA interpretations, Guidance should confirm that any steel or iron requirements should be limited to construction materials made primarily of steel or iron that have a structural, load-bearing, or support function to the qualified facility.

- Guidance should confirm that steel or iron used in components or subcomponents of manufactured products are not subject to separate steel or iron requirements for domestic content, consistent with 49 CFR 661.5(c), but rather is subject to the manufactured products requirements under 49 CFR 661.5(d).

- Guidance should confirm that a wind turbine tower, which supports the turbine, is subject to the rules for steel and iron as the tower provides a support function for the turbine and blades.

- Guidance should confirm that items such as nuts, bolts, flanges, screws, washers, cabinets, covers, shelves, clamps, fittings, sleeves, adapters, tie wire, spacers, door hinges, and similar items that are made of steel or iron are non-structural in nature and are manufactured products or subcomponents of manufactured products and, therefore, those items are not subject to any steel or iron requirements.[4] This is important because it may not be possible to track the origin of certain of these items or there may be no domestic steel source for such items.

- Guidance should clarify that rebar and meshing made of steel or iron which is included in the supporting foundation is subject to the steel or iron standards because it provides a support function along with the foundation for the wind turbine. To be clear, the supporting foundation for the wind turbine is poured onsite and, as discussed later,

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[2] *See* FTA Guidance Letter, KONE Elevators (Jan. 8, 2015), *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/kone-elevators-january-08-2015; FTA Guidance Letter, Southern California Edison (SCE) (Apr. 30, 2014), *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/southern-california-edison-sce-april-30-2014.

[3] *See, e.g.*, KONE Elevators, *supra* fn. 2 (elevator guide rails and doorframes made primarily of steel or iron are treated as subcomponents of the manufactured-component elevator and not subject to 49 CFR 661.5(c)-(d)).

[4] *See, e.g.*, T. Wyatt, Transportation Research Board, Transit Cooperative Research Program, *Legal Research Digest 49: Updated Guide to Buy America Requirements—2015 Supplement*, at 24 (May 2017) (citing FTA, Buy America—Frequently Asked Questions, https://www.transit.dot.gov/funding/procurement/third-party-procurement/buy-america).

should not be classified as a manufactured product or component, but as a construction material.

D. Manufactured Products/Manufacturing Process

Under 49 CFR 661.5(d), for a manufactured product to be considered produced in the United States:

(1) All of the manufacturing processes for the product must take place in the United States; and

(2) All of the components of the product must be of U.S. origin. A component is considered of U.S. origin if it is manufactured in the United States, *regardless of the origin of its subcomponents*.

(emphasis added). In applying this rule, the FTA requires the categorization of items as manufactured end products, components, or subcomponents and, based upon the categorization of any item, the rule above may differ.[5] Although 49 CFR 661.5(d) refers to "manufactured product" and "the product," numerous FTA guidance letters substitute the term "manufactured end product."[6] As an example, the FTA treats the procurement of construction projects as the procurement of a manufactured end product subject to 49 CFR 661.5, and the main elements incorporated into the project at the job site are the components.[7] "As with all manufactured products, Buy America requires all of the manufacturing processes to take place in the United States and all of the components of the product to be of U.S. origin. A component is considered of U.S. origin if it is manufactured in the United States, regardless of the origin of its subcomponents."[8]

The term "end product" means "any vehicle, structure, product, article, material, supply, or system, which directly incorporates constituent components at the final assembly location..., and which is ready to provide its intended end function or use without any further manufacturing or assembly change(s)." 49 CFR 661.3. The term "system" is further defined, in part, as "a machine, product, or device, or a combination of such equipment, consisting of individual components, whether separate or interconnected by piping, transmission devices, electrical

[5] *See, e.g.*, KONE Elevators, *supra* fn. 2; *see also* FTA Guidance Letter, New York Metropolitan Transportation Authority, June 20, 2013, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/new-york-metropolitan-transportation-authority-june-20-2013.
[6] *See, e.g.*, FTA Guidance Letters, LACMTA Buy America Compliance, Subcontractor (Modula, Inc.) Vertical Lift Modules, June 23, 2017, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/los-angeles-county-metropolitan-transportation-authority-august; Securiplex's Water Mist Fire Suppression System for the Second Avenue Subway Project, Aug. 24, 2015, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/fta-letter-mta-securiplex-fire-suppression-systems; Los Angeles County Metropolitan Transportation Authority, Aug. 21, 2013, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/los-angeles-county-metropolitan-transportation-authority-august; Charlotte Area Transit System, Aug. 8, 2013, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/charlotte-area-transit-system-august-08-2013; New York Metropolitan Transportation Authority, *supra*, fn. 5.
[7] *See, e.g.*, FTA Guidance Letter, NYMTA, Aug. 3, 2011, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/nymta-august-03-2011.
[8] *Id.* (citing 49 CFR 661.5(d)).

cables or circuitry, or by other devices, which are intended to contribute together to a clearly defined function." *Id.* The term "component" means "any article, material, or supply, whether manufactured or unmanufactured, that is directly incorporated into the end product at the final assembly location." *Id.* In general, a preassembled item that is manufactured offsite and then delivered to the final assembly location (i.e., the project construction site) is a single component and the various pieces and elements contained within it are classified as subcomponents.[9] The term "subcomponent" is not defined under 49 CFR 661.3, but the FTA has defined it as "those lower-level items that are incorporated into a component through a manufacturing process."[10] The FTA does not designate items or materials below the subcomponent level.[11]

The term "manufactured product" under the BAA is defined as "an item produced as a result of the manufacturing process." 49 CFR 661.3. "Manufacturing process" means:

> the application of processes to alter the form or function of materials or of elements of the product in a manner adding value and transforming those materials or elements so that they represent a new end product functionally different from that which would result from mere assembly of the elements or materials.

Id. This definition is critical to distinguishing components from subcomponents under 49 CFR 661.5(d). Subcomponents may be of foreign origin, but "[i]if no manufacturing processes occur at the component level, then those processes must occur in the U.S. at the subcomponent level. Mere assembly is insufficient to satisfy the manufactured product requirements of 49 C.F.R. 661.5."[12] For example, the FTA has rejected attempts to classify components as subcomponents where the parts in question are imported into the United States "highly manufactured," and then undergo "the use of welding solely for purposes of joining the metal pieces together" without any other meaningful manufacturing processes.[13]

The FTA (its predecessor, the Urban Mass Transportation Administration), in its rulemaking, has stated that "[t]he key element of this definition [of manufacturing of components] is the alteration of subcomponents to form a new product," and provides the following examples comprising manufacturing processes:

> The processes of alteration may include forming, extruding, material removal, welding, soldering, etching, plating, material deposition, pressing, permanent adhesive joining, shot blasting, brushing, grinding, lapping, finishing, vacuum

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[9] *Cf. S.J. Amoroso Constr. Co. v. U.S.*, 26 Cl. Ct. 759, 768 (1992), *affd*., 12 F.3d 1072, 1087 (Fed. CIr. 1993).
[10] *See, e.g.,* FTA Guidance Letter, Delta Composites LLC, Jan. 23, 2015, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/delta-composites-llc-january-23-2015.
[11] *See, e.g.*, KONE Elevators, *supra* fn. 2.
[12] FTA Guidance Letter, KONE Inc., Apr. 9, 2012, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/kone-inc-april-09-2012; *see also* 49 CFR 661.3 (definition of "manufacturing process"); FTA Guidance Letters Santa Cruz Metro, Feb. 9, 2015, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/santa-cruz-metro-february-09-2015; Otis Elevator, Aug. 23, 2013, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/otis-elevator-august-23-2013.
[13] FTA Guidance Letter, Siemens Transp. Systems, Inc., June 3, 2003, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/siemens-transportation-june-03-2003.

impregnating, and, in electrical and electronic pneumatic, or mechanical products, the collection, interconnection, and testing of various elements.

Final Rule, Buy America Requirements, 56 Fed. Reg. 926, 929 (Jan. 9, 1991). Although this specific explanation was given with respect to rolling stock (e.g., railcars, subway cars, and the like) under 49 CFR 661.11, the FTA has applied this same analysis of what is meant by the alteration and transformation of subcomponents in its guidance letters under 49 CFR 661.5.[14] FTA guidance requires, among other things, that subcomponents be installed, integrated, and interconnected to create the manufactured component, and requires activity beyond mere assembly.[15]

Consistent with these authorities, in the case of a § 45 or 45Y facility, the end product is the qualified facility and, in the case of a § 48 or 48E facility, the end product is the energy project. The manufactured product definition does not apply to the qualified facility or energy project as a whole, i.e., a manufactured end product, but to the components of the qualified facility or energy project that are manufactured products. Section 45(b)(9)(B)(i) refers to "any steel, iron, or *manufactured product which is a component of such facility*…" (emphasis added). Further, § 45(b)(9)(B)(iii) refers to "*the manufactured products which are components of a qualified facility*…." The statute is clear that the manufactured products against which the applicable percentage is applied is to components that are manufactured products. As detailed above, the term "component" includes any article, material, or supply that is separately delivered to the project site to be incorporated into the end product, i.e., the qualified facility. Accordingly, any component that is delivered to the project site must fall into the category of (i) manufactured product, (ii) steel or iron, or (iii) other construction material, such as poured concrete, that is not a manufactured product or steel or iron. It would be incorrect to treat the end product, i.e., the qualified facility, as a single manufactured product. It similarly would be incorrect to treat the term "manufactured product," as used in § 45(b)(9)(B)(iii), to refer to an item that is something other than a component. Rather, the term "manufactured product," as used in § 45(b)(9)(B)(iii), must be read to be synonymous with a manufactured component as that term is used in 49 CFR 661.3.

It is worth emphasizing that the term "component" includes any article, material, or supply that is separately delivered to the project site to be incorporated into the end product, i.e., the qualified facility. Thus, any preassembled item that is manufactured offsite and then delivered to the final assembly location (i.e., the project construction site) is a single component and the various pieces and elements contained within it are classified as subcomponents. The origin or cost of any subcomponents is irrelevant to the domestic content determination.

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[14] *See, e.g.*, FTA Guidance Letters, Delta Composites LLC, *supra* fn. 10; San Francisco Municipal Railway, Dec. 7, 2010, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/san-francisco-municipal-railway-december-07-2010; Applicability of FTA's Buy America Rules to a Traffic Signal System, *available at* https://www.transit.dot.gov/sites/fta.dot.gov/files/docs/regulations-and-guidance/buy-america/116556/carter-huffer-2011-06-08.pdf.

[15] *See, e.g.*, FTA Guidance Letters, Otis Elevator, *supra* fn. 12; San Francisco Municipal Railway, *supra* fn. 14; Yonkers Contracting/ThyssenKrupp Elevator, Dec. 7, 2010, *available at* https://www.transit.dot.gov/regulations-and-guidance/buy-america/yonkers-contractingthyssenkrupp-elevator-december-07-2010.

It is also worth emphasizing that onsite construction activities generally do not constitute manufacturing processes for purposes of the FTA rules. This is the case even if items delivered to the site (namely, imported items) are subjected to welding or other normal processes that are construction, by their nature, and not manufacturing or if specialty tradespeople and workers are involved in the construction process. The rolling stock regulation provides guidance in this circumstance. Under 49 CFR 661.11(d), "[a] *component may be manufactured at the final assembly location if the manufacturing process to produce the component is an activity separate and distinct from the final assembly of the end product*." (Emphasis added.) This definition corresponds to the definitions of component, manufactured product, and manufacturing process under 49 CFR 661.3. Namely, a component that is a manufactured product must be produced as a result of the manufacturing process. A component is typically manufactured offsite and delivered as a preassembled item to the final assembly location (i.e., the project site) for incorporation into the end product. Subcomponents should not be permitted to be converted into U.S. manufactured products by being delivered to the project site and then being subjected to some form of construction or installation activity. This interpretation would turn the BAA rules on their head. Likewise, concrete pads and foundations, as well as similar items, which are not delivered to the project site but rather are formed at the site, should not be treated as manufactured products under § 45(b)(9)(B)(iii). This treatment could result in almost all assets at the site being treated as manufactured products. These items should generally be classified as construction materials. Manufacturing of a component onsite should only apply to manufacturing activity which is separate and distinct from final assembly of the end product (i.e., the qualified facility/energy project). For example, if a manufacturer set up a shop on site to refurbish generators, which entails a manufacturing activity, then the production of such generators would constitute a separate manufacturing activity. On the other hand, if an activity involves the installation or assembly of certain components into the end product, it is not manufacturing.

Requested Guidance. Guidance should confirm and/or clarify the following matters with respect to manufactured products used in a qualified facility and the manufacturing process:

- Guidance should confirm that the manufactured product standard in 49 CFR 661.5 applies to determine whether manufactured products that are components of the final product are produced in the United States.

- Guidance should confirm that the same categorization of items is made in a similar manner as the FTA guidance – i.e., a qualified facility is categorized in terms of the end product(s), the manufactured products or components, and the subcomponents. Guidance should also confirm that (i) all of the manufacturing processes for all of the components, which are manufactured products or components of the end product, must take place in the United States, 49 CFR 661.5(d)(1), and (ii) all of the components, which are manufactured products or components of the end product, must be of U.S. origin, i.e., the components are manufactured in the United States (subject to the 40% rule).

- Guidance should confirm, consistent with 49 CFR 661.5(d)(2), that the origin of the subcomponents of a component which is a manufactured product is disregarded for domestic content purposes; provided, however, that there are sufficient manufacturing processes that occur at the component level. Guidance should adopt standards similar to

those used by the FTA in its rulemaking and guidance for determining whether there has been sufficient manufacturing processes at the component level versus mere assembly.

- Guidance should confirm that the final assembly location for purposes of the "end product" definition and the location where the constituent components are directly incorporated is the project site.

- Consistent with FTA interpretations relating to similar construction projects and the statutory language in § 45(b)(9)(B), the Guidance should confirm that the "qualified facility" or "energy project" is the end product. Specifically, consistent with the definition of end product under the BAA rules, the qualified facility or energy project is the product or system that directly incorporates the constituent components at the final assembly location and is ready to provide its intended end function or use without any further manufacturing or assembly change(s). As discussed earlier, the qualified facility for purposes of § 45 or 45Y should be defined in a manner consistent with Rev. Rul. 94-31 (in the case of wind facilities, the tower, turbine, and supporting pad). Therefore, items such as the pad-mount transformers, the SCADA system, and site improvements would not be considered as part of the qualified facility or in identifying the manufactured products for purposes of determining domestic content for purposes of § 45 or 45Y. However, those items may be considered "components" of a wind "energy project" for purposes of § 48 or 48E.

- Guidance should confirm that the components of the wind facility include all preassembled manufactured products delivered to the final assembly location (i.e., the project site). Any subcomponents that are integrated and incorporated into such component prior to delivery to the project site should not be treated as separate components – i.e., they may be foreign-sourced without impacting the categorization at the component level.

- In the case of a wind facility for purposes of § 45 or 45Y, Guidance should confirm that the components of a wind facility, as delivered to the final assembly location, generally consist of the nacelle, rotor, and blades. As noted earlier, Guidance should confirm that the tower is structural steel subject to 49 CFR 661.5(b)-(c).

- In the case of a wind facility for purposes of § 45 or 45Y, Guidance should confirm that the subcomponents of a wind facility include the following items and similar items. With respect to the nacelle, the subcomponents would include the machine head parts and elements, the main shaft, the main bearing, the yaw bearing, bedplate, gearbox, and similar items incorporated within the nacelle – provided, that these subcomponents are subjected to manufacturing processes to convert them to a manufactured component (as defined above) outside of the project site and in order to create the nacelle component. With respect to the rotor, the subcomponents would include the hub, pitch bearing, and certain ancillary items included within the rotor assembly. With respect to the blades, the subcomponents are limited but would include such items as bolts, sealers, and similar items.

- Guidance should address onsite manufacturing activities similar to the guidance in 49 CFR 661.11(d) – i.e., components generally cannot be manufactured at the final assembly location (i.e., the project construction site) unless the manufacturing process is separate and distinct from the assembly of the end product.

- Guidance should confirm that onsite construction activity, such as pouring concrete foundations, is not manufacturing and the cost of such construction activity is not taken into account in determining the applicable percentage of manufactured products. In contrast, preformed concrete pads or enclosures for inverters or other equipment that are manufactured offsite and delivered to the project site would be manufactured products.

E. Manufactured Products/Total Costs

Under § 45(b)(9)(B)(iii), "the manufactured products which are components of a qualified facility upon completion of construction shall be deemed to have been produced in the United States if not less than the adjusted percentage [40%, generally, 20% for offshore wind, and up to 55% under § 45Y] ... of the total costs of all such manufactured products of such facility are attributable to manufactured products (including components) which are mined, produced, or manufactured in the United States." The statute uses the term "manufactured products," which is a defined term under the BAA rules, and also the term "components," another defined term under BAA. The relevant BAA sections, 49 CFR 661.3 and 661.5, do not currently include a cost-ratio or domestic-content percentage similar to the adjusted percentage concept used in the IRA.[16] Neither the domestic content provisions in § 45(b)(9)(B) nor the relevant BAA rules include any guidance on how total costs are determined.

Nevertheless, we believe the intent of how the percentage of manufactured products should be determined is clear from the statutory language and application of the BAA rules to steel and iron, and manufactured products which are components of the end product, which is the qualified facility or energy project. The cost of steel and iron items that are so classified is excluded from the computation. Those items are separately classified from manufactured products. The cost of all of the "manufactured products" which are components of the end product (the qualified facility under § 45) are summed. In order to satisfy the manufactured products requirement for onshore wind (and other qualified facilities and energy projects), not less than 40% (20% for offshore wind and up to 55% in the case of § 45Y) of the total cost of all of the manufactured products incorporated into the qualified facility or energy project must be of U.S. origin. Any breakdown of costs within a manufactured product which is a component is irrelevant. Cost is determined at the manufactured product/component level and every such manufactured product/component is either a U.S. manufactured product or not. Under this construct, Congress has allowed that up to 60% of the cost taken across all manufactured products does not have to be from U.S. manufactured products or components.

[16] The rolling stock provisions in 49 CFR 661.11 include certain cost-ratio or percentage requirements for domestic content, but those provisions were adopted by Congress specifically for rolling stock in legislation enacted after the initial 1978 Buy America Act was enacted. As explained *infra* at fn. 17, those rules were not adopted for the general Buy America Act rules and are not applied by the FTA. While some concepts from this specific rule may be relevant, the rolling stock rule generally is not applicable to the provisions that Congress referenced for qualified facilities here.

The cost of labor at the project site to construct, assemble, or build the qualified facility or energy project is not a cost of the manufactured product and should not be taken into account.

Requested Guidance. Guidance should confirm and/or clarify the following matters with respect to manufactured products and the analysis of total costs under § 45(b)(9)(B)(iii) and (C):

- Guidance should confirm that the 40% adjusted percentage is applied with respect to the qualified facility or energy project (i.e., the end product). Guidance should confirm that the 40% adjusted percentage compares the total costs of all the manufactured components (i.e., "the manufactured products which are components of a qualified facility") of U.S. origin to the total costs of all manufactured components whether of U.S. or foreign origin. This analysis is consistent with prior rulemaking under the BAA, at former 49 CFR 660.22, which provided:

  > (a) In order for a manufactured end product to be considered a domestic end product—(1) the cost of the domestic components must exceed 50 percent of the cost of all its components; and (2) the final assembly of the components to form the end product must take place in the United States.

  Final Rule, Buy America Requirements, 43 Fed. Reg. 57144, 57146 (Dec. 6, 1978).[17]

- Guidance should specifically confirm that the 40% adjusted percentage in § 45(b)(9)(B)(iii) and (C)(i) does not require any comparison or allocation of domestic and foreign costs *at the component or subcomponent level* (i.e., that 40% of the costs of the component or subcomponent must be U.S. origin in order to be treated as domestic). Rather, if a component of the qualified facility or energy project, such as the nacelle, is determined to be a manufactured product of U.S. origin, then the entire cost of that component is treated as domestic content for purposes of the cost comparison in § 45(b)(9)(B)(iii). The individual costs of subcomponents, even if of foreign origin, are included in the cost of the domestically-manufactured component – consistent with 49 CFR 661.5(d)(2). This analysis is consistent with the prior rulemaking under former 49 CFR 660.22, which provided:

  > (b) In determining the origin of components, each component must be treated as either entirely domestic or entirely foreign, based on the place where the component is mined, produced, or manufactured. Components of unknown origin must be treated as foreign. The origin of subcomponents of components is immaterial.

[17] In the Surface Transportation Assistance Act of 1982, Pub. L. 97-424, § 165, 96 Stat. 2097, 2136-37 (Jan. 6, 1983), Congress provided a 50% "waiver" for foreign-sourced components (similar to the above provision) for rolling stock but effectively eliminated this standard for the general Buy America Act rules. Thus, under current 49 CFR 661.5, the domestic manufactured products standard is 100%. Under § 45(b)(9)(C)(i), the manufactured product standard generally is 40 percent.

- Guidance should clarify that total costs do not include property, items, or materials that are not incorporated into the scope of the qualified facility. For example, in the case of a wind facility for purposes of § 45 or 45Y, the costs of pad-mount transformers, the SCADA system, site improvements, and similar assets, as well as costs allocated to those assets, are not included in the determination of the costs of the manufactured components of the qualified facility. However, those costs may be included in total costs in the case of an energy project under § 48 or 48E.

- Guidance should clarify that labor costs and similar costs incurred at the project site for the actual construction or final assembly of the qualified facility or energy project (e.g., contractor and subcontractor labor costs, profit, etc.) are construction costs that are not considered in determining the costs of manufactured components. *See, e.g.*, *S.J. Amoroso Const. Co., Inc. v. U.S.*, 26 Cl. Ct. 759, 771-773 (1992). On the other hand, Guidance should confirm that the cost of the manufactured component delivered to the project site is the total price charged by the manufacturer or other supplier to the project sponsor, developer, contractor, or owner, as the case may be. *Id.* Guidance should confirm that costs of transporting manufactured components to the project site are included in the cost of the manufactured component. *See* 43 Fed. Reg. at 57146 (former 49 CFR 660.22(c)). In other words, the cost that is taken into account is the delivered-to-the-site cost to the taxpayer/owner. The manufacturer's cost of any item it sells is completely irrelevant.

F. Repowered Facilities

The IRS has long ruled that a wind facility that is repowered has a new original placed-in-service date and requalifies for PTCs if the capital cost of the new repowering components equals or exceeds 80 percent of the sum of such new capital costs and the fair market value of any old components retained in the repowered wind turbine (*i.e.*, the "80/20 Rule"). Rev. Rul. 94-31, 1994-1 CB 16. The 80/20 Rule is a longstanding administrative position of the IRS dating back at least to the 1960s, and was established specifically with respect to wind facilities under § 45 in Rev. Rul. 94-31. It has been applied to other § 45 facilities, *see* Notice 2008-60, 2008-30 IRB 178 (biomass), and other PTC facilities such as § 45Q, *see* Treas. Reg. § 1.45Q-2(g)(5). This rule was restated and reaffirmed in Notice 2016-31, § 6.01, 2016-23 IRB 1025, and in Notice 2017-4; 2017-3 IRB 541, specifically with respect to repowering of wind turbines. The 80/20 Rule is well-established and longstanding in the context of § 45 and in the tax law generally.

As a matter of policy, repowering of existing projects is important to achieving renewable energy and climate goals. Advances in technology allow for the productive reuse of older projects by repowering those projects. From an economic and environmental perspective, it makes sense to employ significant new capital to upgrade or "repower" these projects in order to extend their useful lives and increase their efficiency while reusing certain components (e.g., towers and foundations) of the original facility. Because repowered projects use the same environmental footprint, repowering avoids greenfield permitting and construction and takes advantage of sites with existing transmission infrastructure. It is appropriate that repowered projects also benefit from the domestic content bonus credit as an added incentive to develop repowered projects.

Repowering of wind turbines in almost every case results in the reuse of the tower and the foundation. Consistent with the discussion of domestic content above, the tower is the main component of a wind qualified facility that is categorized as steel or iron. Repowering typically involves the replacement of the drivetrain and other items located within a nacelle. In some cases, the entire nacelle may be replaced where the repowering involves the conversion of the main power equipment from one manufacturer to another. Guidance should clarify in the case of wind repowering, where the tower is reused, that all of the components and equipment delivered to the job site are manufactured products. This would include any products made primarily of steel or iron that have undergone a manufacturing process to be incorporated or installed into the repowered turbine, such as adapters used to fit a different manufactured nacelle onto an existing tower. Such adapters are similar to general construction items, like nuts, bolts, flanges, and similar assorted items. *See supra,* p. 8 & fn 4.

Requested Guidance. Guidance should confirm the treatment of qualified facilities that are "repowered."

- Guidance should confirm that domestic content requirements should apply *only* with respect to the "new" property incorporated into the qualified facility and should not apply to any of the used property from the existing facility. For example, in the case of a wind repowering project, if the used property includes the steel tower, the origin of the steel used in the existing tower should not be considered in determining whether the steel or iron requirements of § 45(b)(9)(B)(ii) are satisfied.

- Guidance should confirm the costs of manufactured components under § 45(b)(9)(B)(iii) should include only the costs of the newly-acquired manufactured components that are incorporated into the qualified wind facility and not any value associated with the used property.

- Guidance should confirm in the case where the existing tower and foundation are reused, that the other components delivered to the job site to be installed into the repowered turbine are manufactured products for purposes of the domestic content requirements.

G. Section 45 Facilities Electing ITC

There is a technical issue with the application of the domestic content bonus credit to § 45 qualified facilities, such as offshore wind and incremental hydropower, that elect to claim the ITC under § 48. Certain § 45 qualified facilities can elect to claim the ITC under § 48(a)(5) in lieu of the PTC under § 45. In particular, as noted above, it is widely expected that many offshore wind facilities, which qualify as a wind facility under § 45(c)(1)(A), will make the election to claim the ITC under § 48(a)(5). The fact that offshore wind is eligible for the domestic content bonus is clear in that the "adjusted percentage" of manufactured products for an offshore wind project is 20% instead of the generally applicable 40%. § 45(b)(9)(C)(ii) ("in the case of a qualified facility which is an offshore wind facility, the adjusted percentage shall be 20 percent").

The domestic content provision for ITC is found at § 48(a)(12)(A). It states, in relevant part, "for purposes of applying paragraph (2) with respect to such property…." Section 48(a)(2)

is the provision that sets the "energy percentage" for traditional ITC properties (e.g., solar, geothermal, fuel cells, etc.). However, PTC facilities that elect ITC reside in § 48(a)(5), which has its own "energy percentage" set forth in § 48(a)(5)(A)(ii), which generally corresponds to the energy percentage in § 48(a)(2). The specific reference to § 48(a)(2) in the domestic content provision at § 48(a)(12)(A) could be read to exclude PTC facilities that elect ITC under § 48(a)(5) from receiving the domestic content bonus. Note that the same issue exists for the energy community bonus under § 48(a)(14).

We believe this was merely an oversight by Congress. For example, we note that § 48(a)(5)(A)(i) states that PTC facilities that elect ITC "*shall be treated as energy property for purposes of* ***this section***" (i.e., the entirety of § 48) (emphasis added), and § 48(a)(9)(A)(ii) defines the term "energy project" to include "a project consisting of one or more energy properties that are part of a single project," thus including PTC facilities electing ITC. Section 48(a)(12) does not otherwise restrict domestic content to traditional ITC properties – it references "energy project" broadly in multiple places and states specifically in § 48(a)(12)(C) that "For purposes of subparagraph (A), the applicable credit rate increase shall be…***in the case of an energy project*** which satisfies the requirements of paragraph (9)(B), 10 percentage points." (emphasis added).

Section 45 PTC qualified facilities clearly qualify for the domestic content and energy community bonuses under § 45 (indeed, that is where those bonuses originate). As noted above, offshore wind projects are expressly addressed, and receive a lower adjusted percentage for manufactured products. It would make no sense and would be inequitable if those facilities were denied those same bonuses by electing ITC.

Requested Guidance. Guidance should confirm that all energy projects making an election under § 48(a)(5) that would otherwise qualify for the domestic content bonus under § 45 are eligible for the domestic content bonus credit when making the election to claim ITC under § 48. As a policy matter, those facilities are clearly intended to qualify for the bonus. The fact that such electing facilities are treated as "energy property" and that § 48(a)(12)(C) provides the domestic content bonus credit "*in the case of an energy project* which satisfies the requirements of paragraph (9)(B)" support such treatment.

Under similar analysis, all energy projects making an election under § 48(a)(5) that would otherwise qualify for the energy community bonus under § 45 are eligible for the energy community bonus credit when making the election to claim ITC under § 48.

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Prepared with the assistance of David S. Lowman and Timothy L. Jacobs, Hunton Andrews Kurth LLP