PAUL
HASTINGS

November 4, 2022

Internal Revenue Service
CC:PA:LPD:PR (Notice 2022-51)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments in Response to Internal Revenue Service Notice 2022-51
Request for Comments on Prevailing Wage, Apprenticeship, Domestic Content, and Energy Communities Requirements Under the Act Commonly Known as the Inflation Reduction Act of 2022

Dear Sir or Madam:

We appreciate the opportunity to submit comments in response to Notice 2022-51 regarding questions pertaining to the domestic content and energy community requirements for increased or bonus credit (or deduction) amounts under applicable provisions of the Code. We provide the following comments to address issues that require clarification or additional guidance in future regulations.

A. *3.03.* Domestic Content Requirements

1. *3.03(1).* Sections 45(b)(9)(B) and 45Y(g)(11)(B) provide that a taxpayer must certify that any steel, iron, or manufactured product that is a component of a qualified facility (upon completion of construction) was produced in the United States (as determined under 49 C.F.R. 661).

***3.03(1)(a).* What regulations, if any, under 49 C.F.R. 661 (such as 49 C.F.R. 661.5 or 661.6) should apply in determining whether the requirements of section §§ 45(b)(9)(B) and 45Y(g)(11)(B) are satisfied? Why?**

The IRS should issue guidance that a product that qualifies for the advanced manufacturing credit under Section 45X is a manufactured product is produced in the United States for purposes of the domestic content bonus credit (regardless of whether that product satisfies the requirements of 49 C.F.R. 661). In the Executive Order on the Implementation of the Energy and Infrastructure Provisions of the Inflation Reduction Act of 2022, the President ordered that all agencies, as appropriate and to the extent consistent with law, prioritize "increasing . . . investment in critical supply chains, including through the Act's incentives and measures to strengthen domestic manufacturing and supply chains." Providing that components that qualify for the advanced

manufacturing credit, when incorporated into a facility, are manufactured products produced in the United States could heighten the demand for products qualifying for the advanced manufacturing credit under Section 45X, providing greater certainty to businesses looking to move their manufacturing activities into the United States.

3.03(1)(b). **What should the Treasury Department and the IRS consider when determining "completion of construction" for purposes of the domestic content requirement? Should the "completion of construction date" be the same as the placed in service date? If not, why?**

The "completion of construction" date should align with the date a facility is placed in service (within the meaning of Section 45 or 48, as applicable). A single date for placement-in-service and the completion of construction of a facility would cause the documentation of compliance to be more efficient and cost-effective for taxpayers. Indeed, in the Section 48 credit context, third-party appraisals are typically prepared (or bring-downs of previously prepared appraisals are prepared) as of the date a facility is placed in service to provide support for the eligible basis of the facility upon which the Section 48 credits claimed with respect to that facility will be based. Such appraisals typically include an analysis of the costs of the components of a facility and a cost segregation study to establish which costs are includable in a facility's eligible basis. For facilities for which the domestic content bonus credit will be claimed, an additional analysis could be included in connection with such third-party appraisals to determine the total costs attributable to steel, iron, or manufactured products that were produced in the United States.

2. ***3.03(2).*** **Sections 45(b)(9)(B)(iii) and 45Y(g)(11)(B)(iii) provide that manufactured products that are components of a qualified facility upon completion of construction will be deemed to have been produced in the United States if not less than the adjusted percentage of the total costs of all of such manufactured products of such facility are attributable to manufactured products (including components) that are mined, produced, or manufactured in the United States.**

3.03(2)(a). **Does the term "component of a qualified facility" need further clarification? If so, what should be clarified and is any clarification needed for specific types of property, such as qualified interconnection property?**

Section 45(b)(9)(B)(i) provides that with respect to any qualified facility, the domestic content requirement is satisfied 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 that is a component of such facility (upon completion of construction) was produced in the United States (as determined under 49 C.F.R. Section 661).

We believe the Secretary should provide guidance on the types of objects/products that constitute "components" for purposes of the domestic content rules and provide specific examples for various renewable energy projects, such as solar, wind and battery storage. The Secretary should also clarify whether subcomponents of eligible components may be imported from outside the United States.

3.03(2)(b). **Does the determination of "total costs" with regard to all manufactured products of a qualified facility that are attributable to manufactured products (including components) that are mined, produced, or manufactured in the United States need further clarification? If so, what should be clarified?**

Clarifying guidance is needed with respect to what costs are includable in "total costs" of manufactured products as used in Section 45(b)(9)(B)(iii).

The concept of "total costs" is familiar in the context of Section 45 and 48 credits: In Notice 2018-59, "total costs" are described in connection with the 5% safe harbor, under which construction on energy property is considered as having begun when a taxpayer pays or incurs 5% or more of the total cost of the energy property. Under Notice 2018-59, "[a]ll costs properly included in the depreciable basis of the energy property are taken into account . . . . The total cost of the energy property does not include the cost of land or any property not integral to the energy property . . . ." As a result, costs of labor, overhead, and other intangible costs of the production of a facility—costs that can be capitalized—are included in "total costs."

The definition of "total costs" with regard to manufactured products of a qualified facility that are attributable to manufactured products mined, produced, or manufactured in the United States should similarly include all capitalized costs.

3.03(2)(b). **Is guidance needed to clarify the term "mined, produced, or manufactured"?**

Regulations issued under the former Section 199 domestic production activities deduction discussed tangible personal property "manufactured, produced, grown, or extracted" by a taxpayer in whole or in significant part within the United States. Treasury Regulation Section 1.199-3(e) provided a definition of "manufactured, produced, grown, or extracted." In relevant part, that section provided that that term "includes manufacturing, producing, growing, extracting, installing, developing, improving, and creating [tangible personal property]; making [tangible personal property] out of scrap, salvage, or junk material as well as from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles." Similarly, under income tax sourcing rules with respect to the determination of when inventory is produced in the United States (in Treasury Regulation Section 1.863-3(c)(1)(i)), "production activity means an activity that creates, fabricates, manufactures, extracts, processes, cures, or ages inventory."

Guidance issued with respect to the domestic content bonus credit should similarly provide that "produced" and "manufactured" are expansive terms that include such activities as the creation, fabrication, improvement, and manufacture of tangible property as well as the making of tangible personal property from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles.

The income tax sourcing rules previously mentioned point to the principles of Treasury Regulation Section 1.954-3(a)(4) to determine whether a taxpayer's activities constitute production activity. That regulation generally provides that personal property will be considered manufactured, produced, or constructed if (a) personal property acquired by the manufacturer is substantially transformed or (b) personal property acquired by the manufacturer is used as a component part of the personal property and the assembly or conversion of the component parts into the final product involves activities that are substantial in nature and generally considered to constitute the manufacture, production, or construction of property. Although both methods of establishing production activity are based on the facts-and-circumstances of a particular activity, the IRS included examples in the applicable regulations to provide additional guidance to taxpayers. Similar production and manufacturing guidance could be issued with respect to the domestic content bonus credit, along with thorough examples. Such rules would allow for technological innovations in both the manufacturing processes applicable to facilities and the components that are integrated into those facilities.

The Section 199 regulations expressly excluded certain activities from the definition of "manufactured, produced, grown, or extracted." For example, activities consisting solely of packaging, repackaging, labeling, or minor assembly of tangible personal property were not sufficient. Activities consisting solely of installation (without other production activities) were also not sufficient. The IRS should consider similar exclusions with respect to the domestic content bonus credit.

3.03(2)(c) **Does the term "manufactured product" with regard to the various technologies eligible for the domestic content bonus credit need further clarification? If so, what should be clarified? Is guidance needed to clarify what constitutes an "end product" (as defined in 49 C.F.R. 661.3) for purposes of satisfying the domestic content requirements?**

Under 49 C.F.R. 661.3, a "manufactured product" is defined as "an item produced as a result of the manufacturing process," and a "manufacturing process" is defined as "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." The IRS should clarify whether that definition will be used here or whether the assembly of the elements or materials will result in a "manufactured product" for purposes of the domestic content bonus credit.

49 C.F.R. 661.3 also provides that an "end product" is any vehicle, structure, product, article, material, supply, or system, which directly incorporates constituent components at the final assembly location, that is acquired for public use under a federally-funded third-party contract, and which is ready to provide its intended end function or use without any further manufacturing or assembly change(s). Although this definition provides general guidance, clarification should be provided in the form of examples of what constitutes an "end product" in the context of renewable energy facilities and the domestic content bonus credit.

3.03(2)(e) **Does the treatment of subcomponents with regard to manufactured products need further clarification? If so, what should be clarified?**

Guidance should be issued to address whether subcomponents will be treated differently than components for purposes of determining whether the total costs of manufactured products of a facility are attributable to manufactured products mined, produced, or manufactured in the United States and, if so, to define the term "subcomponent."

3. ***3.03(3).*** **Solely for purposes of determining whether a reduction in an elective payment amount is required under § 6417, §§ 45(b)(10)(D) and 45Y(g)(12)(D) provide an exception for the requirements contained in §§ 45(b)(9)(B) and 45Y(g)(10)(B) (respectively) if the inclusion of steel, iron, or manufactured productions that are produced in the United States increases the overall costs of construction of qualified facilities by more than 25 percent or relevant steel, iron, or manufactured products are not produced in the United States in sufficient and reasonably available quantities or of a satisfactory quality.**

3.03(3)(a). **Does the determination of "overall costs" and increases in the overall costs with regard to construction of a qualified facility need further clarification? If so, what should be clarified?**

Guidance should provide specific standards and metrics that are dynamic as to when the determination is made as to whether the inclusion of steel, iron, or manufactured productions that are produced in the United States is expected to the overall costs of construction of qualified facilities by more than 25% or when such materials are not produced in the United States in sufficient and reasonably available qualities or of a satisfactory qualify.

Guidance should also clarify whether "overall costs" has a different meaning than "total costs," which are discussed above.

4. *3.03(5).* Please provide comments on any other topics relating to the domestic content requirements that may require guidance.

Cost Overruns. The IRS should include provisions allowing for cost overruns when other portions of a facility would otherwise qualify for the domestic content bonus credit.

Notice 2018-59 provides, with respect to the satisfaction of the 5% safe harbor:

> If the total cost of an energy property that is a single project comprised of multiple energy properties . . . exceeds its anticipated total cost, so that the amount a taxpayer actually paid or incurred with respect to the single project turns out to be less than five percent of the total cost of the single project at the time it is placed in service, the Five Percent Safe Harbor is not fully satisfied. However, the Five Percent Safe Harbor will be satisfied and the § 48 credit may be claimed with respect to some, but not all, of the energy properties . . . comprising the single project, as long as the total aggregate cost of those energy properties is not more than twenty times greater than the amount the taxpayer paid or incurred.

The IRS should permit a similar cost overrun provision with respect to the domestic content bonus credit. Thus, for example, for a facility that is a single project comprised of multiple energy properties for which the adjusted percentage is 40%, if the total costs with respect to the manufactured products of the facility attributable to manufactured products mined, produced, or manufactured in the United States turns out to be less than 40% of the total cost of the facility, but the costs attributable to such products within one or more energy properties included in that facility make up at least 40% of the total costs of such energy properties, then the bonus credit amount may be claimed with respect to those energy properties (but not the entire facility).

B. *3.04.* Energy Community Requirement

1. *3.04(1).* Section 45(b)(11)(A) provides an increased credit amount for a qualified facility located in an energy community. What further clarifications are needed regarding the term "located in" for this purpose, including any relevant timing considerations for determining whether a qualified facility is located in an energy community? Should a rule similar to the rule in § 1397C(f) (Enterprise Zones rule regarding the treatment of businesses straddling census tract lines), the rules in 26 C.F.R. §§ 1.1400Z2(d)-1 and 1.1400Z2(d)-2, or other frameworks apply in making this determination?

Rules similar to the rules in Treasury Regulation Sections 1.1400Z-2(d)-1 and 1.1400Z2(d)-2 should apply in determining whether a facility that straddles an energy community is located in an energy community for purposes of Section 45(b)(11)(A). And like the rules in Treasury Regulation Section 1.1400Z-2(d)-1, there should be two methods to determine whether the portion of a facility located in an energy community is substantial compared to the portion of the facility

located outside the energy community: (1) a square footage test, based on the square footage located inside and outside the energy community and (2) an unadjusted cost test, based on the unadjusted cost basis of the facility located inside and outside the energy community.

> **2.** ***3.04(5).*** **For each of the three categories of energy communities allowed under § 45(b)(11)(B), what past or possible future changes in the definition, scope, boundary, or status of a "brownfield site" under § 45(b)(11)(B)(i), a "metropolitan statistical area or non-metropolitan statistical area" under § 45(b)(11)(B)(ii), or a "census tract" under § 45(b)(11)(B)(iii) should be considered, and why?**

To provide certainty to taxpayers in the event of any possible future changes in the definition, scope, boundary, or status of such geographic areas, a taxpayer should be permitted to rely on the definition, scope, boundary, or status in effect at either of two dates applicable to a facility: (1) the date on which the facility begins construction, or (2) the date on which the facility is placed in service.

Conclusion

Thank you for the opportunity to provide comments on questions pertaining to the credit enhancements introduced by the Inflation Reduction Act. We look forward to working with the IRS and Treasury to further clarify these issues as future regulations are considered.

Sincerely,

/s/Paul Hastings, LLP

Paul Hastings, LLP