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Proposed Guidance on the US Clean Vehicle Credit: Critical Minerals and Battery Component Requirements

The US Inflation Reduction Act of 2022 (the "IRA") amended and extended 26 U.S. Code § 30D to provide for a maximum tax credit of $7,500 per qualifying electric vehicle, consisting of a $3,750 credit for vehicles meeting critical minerals requirements and another $3,750 for vehicles meeting battery component requirements (the "30D Credit").[1] This credit is intended not only to spur greater usage of clean electric vehicles, but also incentivize investment in US manufacturing and strengthen supply chains with US-friendly countries, and the credit is expected to have significant impacts on the global supply chains for battery minerals and components.

On March 31, 2023 the IRS released a Notice of Proposed Rulemaking ("NPRM") regarding the 30D Credit. The proposed guidance explains how EV manufacturers can satisfy the critical mineral and battery component requirements under the IRA and will apply to vehicles placed in service after April 17, 2023. The guidance is generally consistent with the proposal floated in a white paper released by the US Department of Treasury on December 29, 2022 (the "30D White Paper").

CRITICAL MINERALS REQUIREMENT

Under the IRA, to meet the critical minerals requirement, the applicable percentage (40% for 2023; 50% for 2024; 60% for 2025; 70% for 2026; and 80% beginning 2027) of the value of the critical minerals contained in an EV battery must be extracted or processed in the US or a country with which the US has a free trade agreement ("FTA Partner Country"), or be recycled in North America.[2] Consistent with the draft framework

in the 30D White Paper, there will be a three-step process for determining the percentage of the value of the applicable critical minerals[3] as follows:

- In Step 1, the manufacturer will determine the procurement chain(s) (a common sequence of extraction, processing, or recycling activities that occur in a common set of locations, concluding in the production of constituent materials) for each applicable critical mineral.
- In Step 2, each applicable critical mineral procurement chain would need to be evaluated to determine whether the critical minerals are "qualifying critical minerals."
  - A critical mineral is a "qualifying critical mineral" if 50% or more of the value added to the critical mineral is derived from (i) extraction that occurred in the U.S. or in an FTA Partner Country, (ii) processing that occurred in the U.S. or in an FTA Partner Country, or (iii) recycling that occurred in North America (which would be defined to include the U.S., Canada and Mexico) (the "50% Test").
    - An FTA Partner Country includes the countries with which the U.S. currently has a free trade agreement in effect (Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, and Singapore), as well as other countries that the Treasury Secretary may identify in the future after considering whether an agreement between the U.S. and the country reduces or eliminates trade barriers and/or restrictions on exports, commits the parties to refrain from imposing new trade barriers, and establishes high-standard disciplines in key areas affecting trade, such as core labor and environmental protections. Japan and the European Union are currently in negotiations with the U.S. to be added as FTA Partner Countries.
  - The 50% Test is effective for vehicles placed in service in 2023 and 2024. For later years, the Treasury Department and the IRS anticipate moving to a more stringent test, and have requested comments on the best approach (such as incrementally increasing the standard over time).
  - The 50% Test is applied separately for each procurement chain. For example, lithium that undergoes initial processing activities in a plant in Country A and then is transferred to a plant in Country B to undergo final processing activities, culminating in the lithium being incorporated into a constituent material, would be analyzed under Step 2 together with other lithium moving through the same procurement chain. However, if some of the lithium instead undergoes final processing activities in a plant in Country C instead of Country B, then there would be two procurement chains for lithium: (1) Country A to Country B and (2) Country A to Country C.
- In Step 3, the percentage of the value of qualifying critical minerals contained in a battery would be calculated by dividing the total value of qualifying critical minerals by the total value of critical minerals.

BATTERY COMPONENTS REQUIREMENT

To meet the battery components requirement, the applicable percentage (50% for 2023; 60% for 2024 and 2025; 70% for 2026; 80% for 2027; 90% for 2028; and 100% beginning 2029) of the value of the battery components must be manufactured or assembled in North America (as defined above).[4] Unlike the critical mineral requirement, there is no allowance for manufacturing/assembling components in other FTA Partner

Countries. Consistent with the draft framework in the 30D White Paper, there will be a four-step process for determining the percentage of the value of the battery components[5] in a battery as follows:

- In Step 1, qualified manufacturers[6] need to determine whether each battery component in a battery was manufactured or assembled in North America (regardless of the location of the manufacturing or assembly activities of the subcomponents).
- In Step 2, qualified manufacturers need to determine the incremental value for each battery component, and whether the incremental value is attributable to North America based on the determination made in Step 1.
- In Step 3, qualified manufacturers would need to determine the total value of the battery components by totaling the incremental values of each battery component determined in Step 2. Alternatively, the total value may be calculated by totaling the value of each battery module.[7]
- In Step 4, qualified manufacturers would need to calculate the percentage of the value of the battery components manufactured or assembled in North America by dividing (1) the sum of the incremental values of all battery components attributable to North America determined in Step 2 by (2) the total value determined in Step 3.

Foreign Entity Restrictions

For vehicles placed in service after December 31, 2023, the 30D Credit is not available if the vehicle's battery contains battery components manufactured or assembled in a "foreign entity of concern."[8] For vehicles placed in service after December 31, 2024, the 30D Credit will not be available if the battery contains critical minerals extracted, processed, or recycled by a "foreign entity of concern."[9] A "foreign entity of concern" includes any foreign entity that is "owned by, controlled by, or subject to the jurisdiction or direction of a government of a foreign entity that is a covered nation," which are China, Russia, Iran and North Korea.[10] Unfortunately, in the latest guidance the IRS did not further clarify this definition and instead indicated it will be addressed in future guidance.

Other 30D Credit Requirements

- **Limitation based on modified adjusted gross income ("AGI")**. The 30D Credit is not available for consumers with modified AGI above certain thresholds ($300,000 for married couples filing jointly, and $150,000 for individuals or married couples filing separately).[11] The proposed regulations clarify that such limitation does not apply to corporations. In the event that the new clean vehicle is placed in service by a partnership or an S corporation, and the 30D Credit is claimed by individuals who are partners of the partnership or shareholders of the S corporation, the limitation applies to those individuals.[12]
- **Final assembly requirement**. Any vehicle must undergo its final assembly in North America to be eligible for the 30D Credit.[13] The proposed regulations provide that "final assembly" means the process by which a manufacturer produces a new clean vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the vehicle's mechanical operation included with the vehicle.[14]

- **Manufacturer's suggested retail price ("MSRP").** The 30D Credit is not available for a vehicle with an MSRP in excess of certain thresholds ($80,000 for vans, sport utility vehicles and pickup trucks; $55,000 for others).[15] The proposed regulations provide that MSRP means the sum of (1) the retail price of the automobile suggested by the manufacturer, and (2) the retail delivered price suggested by the manufacturer for each accessory or item of optional equipment, as reported on the label affixed to the windshield or side window of the vehicle.[16]

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ENDNOTES

1 Prior to the IRA, the 30D credit amount was determined based on the vehicle's battery capacity.
2 § 30D(e)(1)(B); Prop. Reg. § 1.30D-3(a)(2).
3 Critical minerals include lithium, nickel, cobalt and other critical minerals as listed under § 45X(c)(6).
4 § 30D(e)(2)(B); Prop. Reg. § 1.30D-3(b)(2).
5 "Battery component" is defined as a component that forms part of a battery and which is manufactured or assembled from one or more components or constituent materials that are combined through industrial, chemical, and physical assembly steps, including a cathode electrode, anode electrode, solid metal electrode, separator, liquid electrolyte, solid state electrolyte, battery cell, and battery module.
6 A "qualified manufacturer" is a manufacturer that enters into a written agreement with the Secretary under which the manufacturer agrees to make periodic written reports to the Secretary providing vehicle identification numbers and other information related to each vehicle.
7 *Id*.
8 § 30D(d)(7)(B).
9 § 30D(d)(7)(A).
10 § 30D(d)(7)(A) (using the definition under section 40207(a)(5) of the Infrastructure Investment and Jobs Act (42 U.S.C. 18741(a)(5))).
11 § 30D(f)(10), Prop. Reg. § 1.30D-4(b).
12 Prop. Reg. § 1.30D-4(b)(5).
13 § 30D(d)(1)(G).
14 Prop. Reg. § 1.30D-2(b).
15 § 30D(f)(11).
16 Prop. Reg. § 1.30D-2(c).

Questions regarding the matters discussed in this publication may be directed to Isaac Wheeler, Inosi Nyatta, Sam Saunders or any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. Additional S&C resources about energy transition matters may be found here.