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Guidance out on U.S. Domestic Content Bonus Clean Energy Tax Credits

The U.S. Inflation Reduction Act of 2022 (the "IRA") created bonus credits with respect to production tax credits ("PTC", 26 U.S. Code §§ 45 and 45Y) and investment tax credits ("ITC", §§ 48 and 48E) for qualified clean energy facilities or projects that meet certain domestic content requirements (the "Domestic Content requirements"). More specifically, the otherwise applicable PTC rate is increased by 10%, and the ITC rate is increased by 10 percentage points (or two percentage points if the facility is subject to, and does not satisfy, separate prevailing wage and apprenticeship requirements). In general, the Domestic Content requirements are satisfied by certifying to the Secretary of the Treasury that any steel, iron or manufactured product that is a component of the applicable project was "produced in the United States."

On May 12, 2023, the Department of the Treasury and the Internal Revenue Service (the "IRS") released Notice 2023-38 describing rules that are intended to be included in the forthcoming proposed regulations regarding the domestic bonus credit requirements (the "Notice").

Steel and Iron Requirements

In the case of steel or iron, the Notice clarifies that consistent with the Buy America Act and its regulations, all manufacturing processes with respect to any steel or iron that is a component of the applicable project must take place in the United States, except for metallurgical processes involving refinement of steel additives.[1] While such requirement applies to components that are construction materials made primarily of steel or iron and are structural in function, it does not apply to steel or iron used in components or subcomponents of manufactured products. The Notice gives examples of items that are made primarily of steel or iron but are not structural in function (and therefore are not subject to the requirement), including nuts, bolts, screws, cabinets, and door hinges.[2]

Manufactured Products Requirements

In addition to the steel and iron requirements, the applicable project must also incorporate the applicable minimum "adjusted percentage" of U.S. manufactured products, consistent with the Buy America regulations. Specifically, at least 40% for most qualifying energy projects (and 20% for certain offshore wind projects) of the total costs of all manufactured products that are components of the applicable project must be attributable to manufactured products and components which are mined, produced, or manufactured in the United States.[3] The adjusted percentages are subject to increases, stepping up to 55% for projects that begin construction after December 31, 2026 (or after December 31, 2027 for offshore wind projects). A manufactured product is considered to be produced in the United States if: (1) all of the manufacturing processes for the manufactured product take place in the United States, and (2) all of the manufactured product components are manufactured in the United States, regardless of the origin of its subcomponents.

The adjusted percentage is calculated by dividing (i) the direct costs (such as direct materials and direct labor costs) of manufactured products that are produced in the United States and manufactured product components that are mined, produced or manufactured in the United States, by (ii) the direct costs of all manufactured products that are components of the applicable project.[4] The Notice provides an example on how to calculate an adjusted percentage.

Safe Harbor for Components of Certain Energy Projects

In order to help taxpayers determine the classification of project components, the Notice details a safe harbor for classifying typical components of utility-scale photovoltaic systems, land-based wind facilities, offshore wind facilities, and battery energy storage technologies, as recommended by the Federal Transit Administration and the Department of Energy.[5] The Notice clarifies that the components contained in the notice are not an exhaustive set and seeks further input from the public.

Retrofitted Projects

The Notice provides that an applicable project that is placed in service after December 31, 2022, and meets the so-called “80/20 rule” is eligible for the domestic content bonus credit. The 80/20 rule requires that no more than 20% of the applicable project’s total value comes from existing equipment. The “new” property in the applicable project used in these retrofitted projects must meet the Domestic Content requirements to qualify for the domestic content bonus.

Certification Requirements

In order to certify compliance with the Domestic Content requirements, a taxpayer must submit a statement to the IRS certifying that any qualifying steel or iron items or manufactured products meet Domestic Content requirements as of the date the applicable project is placed in service.[6] The statement must be attached to Form 8835, *Renewable Electricity Product Credit*; Form 3468, *Investment Credit*; or other applicable form that is filed with the taxpayer’s annual return for the first taxable year in which the taxpayer reports a domestic content bonus credit amount. For succeeding years in which a credit is claimed (for the PTC), the taxpayer must attach the same statement that was initially submitted.

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ENDNOTES

1 Notice 2023-38, § 3.02.

2 Other examples include washers, covers, shelves, clamps, fittings, sleeves, adapters, tire wire and spacers.

3 Notice 2023-38, § 3.03.

4 Notice 2023-38, § 3.03(2).

5 Notice 2023-38, § 3.04.

6 Notice 2023-38, § 5.

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.