

TURNING GREEN INTO MORE GREEN: PROPOSED REGULATIONS REVISE THE INTERNAL REVENUE CODE IN PUSH FOR "NEW CLEAN VEHICLES" AND TAX CREDITS

On March 31, 2023, the U.S. Treasury Department and the Internal Revenue Service ("IRS") released proposed [guidance](#) for the "new clean vehicle" provisions of the Inflation Reduction Act of 2022 ("IRA"), clarifying how the proposed tax credits will work as part of the Administration's push (and financial incentives) around the energy transition, including in the automotive sector. While the approach is simple, tax credit eligibility and the mechanics, as described below, require a careful reading through defined terms, navigating multi-step processes, and a calculator.

Subject to certain restrictions, Section 30D(a) of the Internal Revenue Code ("Code") provides a tax credit (a personal credit or general business credit) with respect to each "new clean vehicle" that a taxpayer purchases and places in service. The IRA amended Section 30D in a number of significant ways. For vehicles placed in service after the date of the proposed regulations, Section 13401(a) of the IRA amended Section 30D(b) of the Code to provide a maximum credit of \$7,500 per vehicle, consisting of \$3,750 where a vehicle meets certain requirements relating to critical minerals (the "Critical Minerals Requirement") and \$3,750 where a vehicle meets certain requirements relating to battery components (the "Battery Component Requirement"). However, no tax credit pursuant to

Section 30D may be taken with respect to a vehicle placed in service after December 31, 2032.

What is a "New Clean Vehicle"?

"New Clean Vehicle" means a motor vehicle that satisfies 8 factors:

- the original use of the motor vehicle must commence with the taxpayer;
- the motor vehicle must be acquired for use or lease by the taxpayer and not for resale;
- the motor vehicle must be made by a Qualified Manufacturer;
- the motor vehicle must be treated as a motor vehicle for purposes of title II of the Clean Air Act;
- the motor vehicle must have a gross vehicle weight rating of less than 14,000 pounds;
- the motor vehicle must be propelled to a significant extent by an electric motor which draws electricity from a battery that has a capacity of not less than 7 kilowatt hours, and is capable of being recharged from an external source of electricity;
- the final assembly of the motor vehicle must occur within North America;
- the person who sells any vehicle to the taxpayer must furnish a report to the taxpayer and to the Secretary, at such time and in such manner as the Secretary provides, containing specifically enumerated items.

What is the Critical Minerals Requirement?

Section 30D(1)(A) of the Code provides that the Critical Minerals Requirement, with respect to the battery from which the electric motor of a vehicle draws electricity, is satisfied if the *percentage of the value of the applicable critical minerals* (as defined in section 45X(c)(6)) contained in such battery that were (i) extracted or processed *in the United States, or in any country with which the United States has a free trade agreement in effect*, or (ii) recycled in North America, is *equal to or greater than the applicable percentage* (as certified by the "qualified manufacturer", in such form or manner as prescribed by the Secretary).

A "Qualified Manufacturer" means any manufacturer (within the meaning of the regulations prescribed by the Administrator of the Environmental Protection Agency for purposes of the administration of title II of the Clean Air Act (42 U.S.C. 7521 et seq.)) that enters into a written agreement with the Secretary of the Treasury under which such manufacturer agrees to make periodic written reports to the Secretary providing vehicle identification numbers and such other information related to each vehicle manufactured by such manufacturer as the Secretary may require.

The applicable percentage for the Critical Minerals Requirement is set forth in section 30D(e)(1)(B)(i) through (v) of the Code and varies based on when the vehicle is placed in service. In the case of a vehicle placed in service after the date of issuance of the proposed guidance described in new section 30D(e)(3)(B)

of the Code and before January 1, 2024, the applicable percentage is *40 percent*. In the case of a vehicle placed in service during calendar year 2024, 2025, and 2026, the applicable percentage is *50 percent, 60 percent, and 70 percent, respectively*. In the case of a vehicle placed in service after December 31, 2026, the applicable percentage is *80 percent*.

What is the Battery Components Requirement?

Section 30D(e)(2)(A) of the Code provides that the Battery Components Requirement with respect to the battery from which the electric motor of a vehicle draws electricity is satisfied if the *percentage of the value of the components contained in such battery that were manufactured or assembled in North America is equal to or greater than the applicable percentage* (as certified by the qualified manufacturer, in such form or manner as prescribed by the Secretary).

The applicable percentage for the Battery Components Requirement is set forth in section 30D(e)(2)(B)(i) through (vi) of the Code and varies based on when the vehicle is placed in service. In the case of a vehicle placed in service after the date of issuance of the proposed guidance described in section 30D(e)(3)(B) of the Code and before January 1, 2024, the applicable percentage is *50 percent*. In the case of a vehicle placed in service during calendar year 2024 or 2025, the applicable percentage is *60 percent*. In the case of a vehicle placed in service during calendar year 2026, 2027, and 2028, the applicable percentage is *70 percent, 80 percent, and 90 percent, respectively*. In the case of a vehicle placed in service after December 31, 2028, the applicable percentage is *100 percent*.

UNDERSTANDING THE PROPOSED REGULATIONS

Critical Minerals Requirement

The proposed regulations establish a three-step process for determining the value of the critical minerals contained in a battery.

Step 1 requires a manufacturer to determine the "procurement chain" for each critical mineral. Proposed §1.30D-3(c)(14) defines a "procurement chain" as a "common sequence of extraction, processing, or recycling activities that occur in a common set of locations, concluding in the production of constituent materials." Further, a "single . . . critical mineral may have multiple procurement chains if, for example, one source of . . . critical minerals undergoes the same extraction, processing, or recycling process in different locations." Step 2 requires that each procurement chain for each critical mineral be evaluated to determine whether such critical minerals were "(1) extracted or processed in the United States, or in any country with which the United States has a free trade agreement in effect, or (2) recycled in North America." Proposed §1.30D-3(c)(17) would use a "50% of value added test" to determine whether this definition is satisfied, meaning if "(1) 50 percent or more of the value added to the . . . critical mineral by extraction is derived from extraction that occurred in the United States or in any country with which the United States has a free trade agreement in effect; or (2) 50 percent or more of the value added to the . . . critical mineral by processing is derived from processing that occurred in the United States or in any country with which the United States has a free trade agreement in effect." With respect to the "recycled in North America" test, the same "50% of value added test" also apply. The

proposed regulations have detailed definitions of the words "extraction," "processing," "constituent minerals," and "recycling."

The IRS envisions the "50% of value added test" applying for vehicles placed in service in 2023 and 2024; however, a more stringent test may be used for vehicles placed in service after 2024, which would take into account more detailed tracking throughout a manufacturer's supply chain.

Proposed regulation §1.30D-3(c)(24) defines "value" with respect to property, "as the arm's-length price that was paid or would be paid for the property by an unrelated purchaser." This would be determined in accordance with principles of Section 482 of the Code, a section of the Code that governs transfer pricing. With respect to the qualifiers "extraction," "processing," and "recycling" of critical minerals, proposed §1.30D-3(c)(25) defines "value added" as the "increase in the value of the . . . critical mineral attributable to the relevant activity."

Of particular importance, proposed §1.30D-3(c)(7) defines the term "country with which the United States has a free trade agreement in effect" and includes a list the countries with which the United States has a "free trade agreement in effect." There is no definition of "free trade agreement" contained in the IRA or the Code, but based upon the underlying goals of the IRA as well as a number of other considerations, the IRS has proposed the following criteria within the context of an agreement between the United States and another country "as to the critical minerals contained in electric vehicle batteries or more generally, and in the context of the overall commercial and economic relationship between that country and the United States":

- does the agreement reduce or eliminate trade barriers on a preferential basis,
- does the agreement commit the parties to refrain from imposing new trade barriers,
- does the agreement establishes high-standard disciplines in key areas affecting trade (such as core labor and environmental protections), and/or
- does the agreement reduce or eliminate restrictions on exports or commit the parties to refrain from imposing such restrictions on exports.

Based upon these factors, the IRS identified the following countries as having a "free trade agreement in effect" with the United States: Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, and Singapore. Japan was also included in the list because on March 28, 2023, the United States and Japan entered into a "Critical Minerals Agreement" which contained "robust obligations to help ensure free trade in critical minerals, . . . commitment[s] to refrain from imposing duties on exports of critical minerals [and] confer on investments . . . that may affect national security, and detailed undertakings related to the enforcement of labor and environmental laws related to trade in those critical minerals." (Which we wrote about [here](#)).

The foregoing list may be revised and updated pursuant to the procedures set forth in proposed § 1.30D-3(c)(7)(iii), and, the IRS and the Treasury Department may include other countries after considering the factors listed above. The

guidance allows for the Secretary to make any necessary amendments to the list, which would include adding any new countries with "new qualifying international agreements". According to the Treasury Department, the IRA's amendments to Section 30D was intended for vehicle manufacturers to increase their reliance on US supply chains and countries with which the US has "reliable and trusted economic relationships."

Finally, Step 3 involves the "calculation of the percentage of the value of qualifying critical minerals contained in a battery" by finding the percentage of "qualifying critical mineral content", i.e. the percentage of the value of critical minerals used in an electric vehicle battery "that were extracted or processed in the United States, or in any country with which the United States has a free trade agreement in effect, or were recycled in North America." Pursuant to proposed §1.30D-3(a)(3)(i), the percentage would be calculated by finding the quotient of the "total value of qualifying critical minerals by the total value of critical minerals." The proposed regulations provide two mechanisms to determine qualifying critical mineral content. The first is on a vehicle by vehicle basis and the second is based upon an averaging formula.

The results of Step 3 are compared to the relevant applicable critical minerals percentages provided in proposed §1.30D-3(a)(2) to determine whether a vehicle satisfies the Critical Minerals Requirement described in section 30D(e)(1)(A) of the Code.

Battery Components Requirement

Proposed §1.30D-3(b) provides a four-step process for determining the percentage of the value of the battery components in a battery that contribute toward meeting the Battery Components Requirement.

Step 1 requires "qualified manufacturers" to determine whether each battery component (a "substantially all" test) was manufactured or assembled in North America. With respect to a "battery component," the regulations would define "manufactured" as the "industrial and chemical steps taken to produce a battery component" and "assembled" as the "process of combining battery components into battery cells and battery modules."

Step 2 requires "qualified manufactures" to determine the incremental value for each battery component and identify the incremental value of each battery component attributable to those that have been manufactured or assembled in North America. In Step 3, "qualified manufacturers" are required to identify the total incremental value of all battery components.

Finally, in Step 4, "qualified manufacturers" would be required to determine "qualifying battery component content" which will be defined as the "percentage of the value of the battery components contained in the battery from which the electric motor of a new clean vehicle draws electricity that were manufactured or assembled in North America." This is calculated by finding the dividing the incremental value of battery components manufactured or assembled in North America by the total incremental value of all battery components.

This percentage is then "compared with the relevant applicable battery components percentage provided in proposed §1.30D-3(b)(2) to determine whether a vehicle satisfies the Battery Components Requirement."

The comment period for the proposed guidance ends on June 16, 2023. Parties interested in making a public comment on the proposed guidance are encouraged to submit electronic comments through the [Federal eRulemaking Portal](#) (indicate IRS and REG-120080-22). If the public has any questions, the point of contact is the IRS Office of Associate Chief Counsel (Passthroughs & Special Industries) at (202) 317-6853.

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