

PUBLICATION

Department of the Treasury and IRS Issue Proposed Regulations for Advanced Manufacturing Production Credits

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Internal Revenue Code (IRC) Section 45X:

The Inflation Reduction Act of 2022 (IRA) established several incentives targeted at encouraging domestic investment in clean energy. Among those incentives was the Advanced Manufacturing Production Credit (AMPC) contained in the newly enacted IRC Section 45X. The AMPC established a dollar-for-dollar tax credit for the production (within the United States) and sale of certain eligible components including solar and wind energy components, inverters, qualifying battery components, and applicable critical minerals.

Some background on the AMPC may be helpful. To be eligible for the AMPC, a taxpayer must be engaged in the trade or business of production and selling eligible components and the relevant sale must be made to an unrelated third party. If those criteria are satisfied, the taxpayer may claim a tax credit based on the volume and type of eligible component produced and sold, or the cost of production in the case of critical minerals. For example, for the production and sale of a battery cell, the credit amount is 35 dollars multiplied by the capacity of the battery cell expressed in a kilowatt-hour basis. For a solar module, the credit amount is seven cents multiplied by the module's capacity expressed on a per direct current watt basis. For the production of any critical minerals, the credit is equal to ten percent of the costs of production. The credit amount will phase out beginning in 2030.

The Proposed Regulations:

As common under the IRC, Congress leaves many unanswered questions in Section 45X. In turn, it relies on the Treasury and IRS to publish additional guidance and interpretation. The Treasury and IRS issued Proposed Regulations on December 14, 2023, and are currently seeking comment by February 13, 2024. A public hearing will be held on the Proposed Regulations on February 22, 2024. Though not technically authoritative, these Proposed Regulations provide valuable insight into the IRS's interpretation of key provisions of Section 45X at least until final Regulations are issued. This article is not intended to be a comprehensive discussion of the Proposed Regulations, but some highlights are discussed below.

"Produced by the Taxpayer"

IRC Section 45X requires that an eligible component is "produced by the taxpayer", which was left undefined. "Produced by the taxpayer" appears in other similar contexts within the IRC, notably in IRC Sections 263A and 199. The Proposed Regulations eliminate any uncertainty and state that for purposes of Section 45X, "produced by the taxpayer" means a process conducted by the taxpayer that substantially transforms constituent elements, materials, or subcomponents into a complete and distinct eligible component that is functionally different from that which would result from the mere assembly or superficial modification.

The Proposed Regulations set forth examples illustrating activities that constitute partial transformation, mere assembly (e.g. purchasing and combining two finished halves of a wind turbine), or superficial modification (e.g. installing external casing on a battery) ineligible for the AMPC. While those examples are certainly helpful, it is somewhat disappointing the Proposed Regulations fail to provide any examples of borderline applications that would rise to substantial transformation.

"Produced in the United States"

The Proposed Regulations expand on the requirement under Section 45X that eligible components must be produced within the United States. Significantly, subcomponents, including constituent elements and materials used in the production of eligible components, are *not* required to be produced within the United States to claim the credit. This result is contrary to many of the other related clean energy incentives created under the IRA which require a minimum amount of domestically produced subcomponents.

"Production and Sale in a Trade or Business"

Similar to the term "produced by the taxpayer," the term "trade or business" has varying meanings throughout the IRC. The Proposed Regulations clarify this term has the meaning as defined under IRC Section 162, Trade or Business Expenses.

Sales to Unrelated Persons:

A threshold requirement of the AMPC is that the sale be made to an unrelated person. The Proposed Regulations define related and unrelated persons for the purposes of Section 45X. The term "person" includes a trust, estate, partnership, association, company, or corporation. "Related person" means a person who would be treated as the same employer for purposes of common control under IRC Section 52(b). An unrelated person is any person who is not related.

On its face, a sale to a related person is ineligible for the AMPC. However, consistent with congressionally delegated authority under Section 45X, the Treasury provides a mechanism in the Proposed Regulations for electing to treat related persons as unrelated persons by providing certain identifying information on a timely filed return. In creating that mechanism, the Proposed Regulations explicitly recognize that a purpose of Section 45X is to provide taxpayers with an incentive to produce eligible components in a manner that contributes to the development of secure and resilient supply chains. An anti-abuse provision is adopted whereby the IRS may deny the AMPC to a taxpayer if the primary purpose of the production and sale is to obtain the benefit of the AMPC in a manner that is wasteful, such as discarding, disposing of, or destroying the eligible component without putting it to productive use.

Eligible Components and Applicable Critical Minerals:

The Proposed Regulations set forth guidance for calculating and substantiating the credit amount for each different class of eligible components, including solar energy components, wind energy components, inverters, and qualifying battery components. Detailed guidance is also given regarding the calculation of production costs for Applicable Critical Minerals. In the preamble to the Proposed Regulations, the IRS expressly recognized its inability to identify all the wide-ranging costs incurred in the production of certain materials, including but not limited to extraction costs and other direct and indirect materials costs. So the IRS left open the possibility that the definitions addressed under the Proposed Regulations may be broadened after they have the opportunity to consider public comments.

For more information regarding these proposed regulations, contact [Charles W. "Chuck" Goldberg Jr.](#) or any member of Baker Donelson's [Tax Group](#).