

## IRS Publishes Guidance on the Prevailing Wage and Apprenticeship Requirements Under the IRA

***Projects that start construction within 60 days from the publication of the Notice are exempt from the requirements.***

### Key Points:

- Taxpayers now have until January 29, 2023, to start construction on a project to avoid application of the Prevailing Wage and Apprenticeship Requirements.
- A taxpayer can demonstrate beginning of construction using the Physical Work Test or Five Percent Safe Harbor methods (each as defined below) previously blessed by the IRS.
- After beginning construction, projects that rely on the Physical Work Test or Five Percent Safe Harbor must be completed within a safe harbor period ranging from four to six years, or prove that progress towards completion was continuous based on facts and circumstances.
- For projects that do not begin construction on or before January 29, 2023, the Notice explains how projects can satisfy the prevailing wage and apprenticeship requirements, largely following the well-established principles of the Davis-Bacon Act of 1931 (the Davis-Bacon Act).

On November 30, 2022, the IRS issued [Notice 2022-61](#) (the Notice), the first substantive piece of guidance under the Inflation Reduction Act (the IRA).

The guidance pertains to the prevailing wage requirement (the Prevailing Wage Requirement) and the apprenticeship requirement (the Apprenticeship Requirement, and together with the Prevailing Wage Requirement, the Prevailing Wage and Apprenticeship Requirements) that will be necessary for green energy projects to qualify for the full value of tax credit subsidies enacted by the IRA earlier this year.

The Notice follows a broad request by the IRS issued in September 2022 asking for feedback from industry participants on how best to implement various aspects of the green energy tax provisions in the IRA.

The Prevailing Wage and Apprenticeship Requirements are a cornerstone component of virtually all the green energy tax subsidies enacted by the IRA. They require green energy projects to pay prevailing wages to the mechanics and laborers that build and maintain these projects and mandate that a minimum number of labor hours be performed by qualified apprentices.

Projects that do not comply with these rules will forfeit up to 80% of the value of their tax credits.

The Notice features two important aspects of IRS guidance.

The first aspect of the Notice describes which projects are exempt from complying with the Prevailing Wage and Apprenticeship Requirements. Projects that begin construction on or before January 29, 2023 need not comply with the Prevailing Wage and Apprenticeship Requirements to receive the full value of the tax credit subsidies.<sup>1</sup> The Notice defines beginning of construction by reference to a set of earlier IRS rules that have been published over the past decade. Those rules liberally permit projects to be treated as under construction when some amount of physical work has commenced either at the project site or by a manufacturer of certain critical project components. Projects owners can also incur 5% or more of the project's cost as a means of establishing that their project is under construction for purposes of those rules. After beginning construction, those rules require projects to be completed within a safe harbor period ranging from four to six years, or to prove that progress towards completion was continuous based on facts and circumstances.

The second aspect of the Notice outlines the technical requirements for those projects that are not exempt from the rules and wish to qualify for the full value of green energy tax credits. The Notice fills in some important details about how to apply these rules, largely incorporating the well-established principles of the Davis-Bacon Act. The Davis-Bacon Act was enacted by Congress in 1931 and directs the Department of Labor to determine prevailing wage rates for most contractors and subcontractors performing on federally funded or assisted contracts for the construction, alteration, or repair of public works projects. The Department of Labor has issued numerous pieces of guidance interpreting the Davis-Bacon Act, including defining concepts such as "construction, alteration or repair" and "laborer or mechanic." Nevertheless, the Notice leaves open a number of important questions that will need to be addressed in supplemental guidance, including the definitions of a contractor and subcontractor.

## Clarity on the Beginning of Construction Rules

### Beginning of Construction Notices

The "beginning of construction" standard is not new to the renewable energy industry. Prior to the IRA, the Internal Revenue Code of 1986, as amended (the Code), subjected the investment tax credit for solar projects (the ITC), the production tax credits for wind projects (the PTC) and the carbon capture credit (the Carbon Capture Credit) to a phase down based on the year in which construction of the applicable project had begun. For purposes of the phase down, the IRS had issued a number of notices that explained how a project could begin construction (the Beginning of Construction Notices).

Under the Beginning of Construction Notices, a taxpayer could demonstrate beginning of construction by (i) starting onsite or offsite physical work of a significant nature (the Physical Work Test) or (ii) paying or incurring five percent or more of the total cost of the project (the Five Percent Safe Harbor). Once a project began construction, it was required to comply with a continuity requirement unless it was placed in service within a safe harbor period which was no more than four calendar years (or six calendar years in the case of the carbon capture credit) after the calendar year during which construction of the project had begun. In response to COVID-19-related delays, the safe harbor period was extended to six years for PTC and ITC projects that had begun construction in 2016, 2017, 2018, or 2019, and five years for PTC and ITC projects that had begun construction in 2020.

### Physical Work Test and Five Percent Safe Harbor

The Notice confirms that the Beginning of Construction Notices will apply with respect to the ITC, PTC and the Carbon Capture Credit for purposes of the Prevailing Wage and Apprenticeship Requirements.<sup>2</sup>

Thus, a project can demonstrate beginning of construction prior to the end of the 60-day period through either the Physical Work Test or the Five Percent Safe Harbor. This guidance is helpful for an industry that is already familiar with these standards and provides more certainty on how projects can avoid the application of the Prevailing Wage and Apprenticeship Requirements.

### **Continuity Requirement**

The Notice also imports the continuity requirement for purposes of the Prevailing Wage and Apprenticeship Requirements. Although many in the industry believed that the continuity requirement, if retained at all, should be measured from a date that is aligned with the effective date of the prevailing wage and apprenticeship requirements (e.g., passage of the IRA or issuance of relevant guidance), the Notice requires that the continuity requirement be tested from the earliest date that a project began construction.

## **Prevailing Wage Requirements**

### **Satisfying the Requirements**

For projects that do not begin construction on or before January 29, 2023, the Prevailing Wage Requirements must be satisfied to claim the full credit amount. The Prevailing Wage Requirements generally require that all laborers and mechanics employed by a taxpayer and any contractors or subcontractors of the taxpayer with respect to a project are paid the prevailing wage for the locality in which the facility is located for work performed in the construction of the facility and for ongoing repairs and alterations during the applicable tax credit period (which ranges from five years for ITC projects to 12 years for Carbon Capture Credit projects). An individual is considered “employed” for this purpose if the individual receives remuneration for services, regardless of whether the individual is an employee or independent contractor for other purposes. The Notice does not define a contractor or subcontractor, nor does it provide guidance to situations in which the Prevailing Wage Requirement (or Apprenticeship Requirement) may apply to property owned by taxpayers other than the taxpayer constructing the qualified facility, for example, if a power plant and the associated carbon capture equipment are owned by unrelated parties.

As many in the industry had requested, the Notice defines several key terms used with respect to the prevailing wage requirements via reference to the Davis-Bacon Act. However, whether these cross-referenced definitions apply neatly to clean energy facilities is not clear in many cases. Under these rules, “wages” generally means the basic hourly rate of pay and certain fringe benefits. A “laborer or mechanic” generally includes workers whose duties are manual or physical in nature, including workers who use tools or who are performing the work of a trade, as distinguished from mental or managerial. This term also includes foremen who devote more than 20% of their time during a workweek to mechanic or laborer duties. “Construction, alteration, or repair” generally includes all types of work done on a particular building or work at the construction site by laborers and mechanics employed by a construction contractor or construction subcontractor.

### **Prevailing Wage Determinations**

The Code provides that the Secretary of Labor determines the prevailing wages, and the Notice clarifies that the Secretary of Labor publishes prevailing wage determinations on [www.sam.gov](http://www.sam.gov). If the Secretary has published a determination which applies to the project’s geographic area and to the type of construction that will apply to the project (including labor classifications for construction, alteration or repair work performed by laborers and mechanics on the project), then the taxpayer should use this as the prevailing wage. If no prevailing wage for the geographic area and type of construction has been

published, then the taxpayer must request a wage determination or wage rate from the Department of Labor by contacting [IRAprevalingwage@dol.gov](mailto:IRAprevalingwage@dol.gov), and provide the type of facility, facility location, proposed labor classifications, proposed prevailing wage rates, job descriptions and duties, and any rationale for the proposed classifications.

### General Recordkeeping

The Notice requires a taxpayer, along with any contractors and subcontractors, to maintain books of account and records of work performed in sufficient form to establish that the taxpayer, its contractors, and subcontractors have satisfied the prevailing wage requirements with respect to the facility.

### Correction Payments and Penalties for Failures

Though not explicitly addressed by the Notice, for taxpayers who fail to meet the Prevailing Wage Requirements, the Code allows for true-up payments to satisfy these rules. If a laborer or mechanic was not paid the prevailing wage for any period, the taxpayer may pay such worker the difference between the prevailing wage and the amount the worker was actually paid. The taxpayer must also pay interest equal to the amount of the shortfall multiplied by the federal short-term rate plus 6% for the period in which the worker rendered services. Additionally, the taxpayer must remit to the IRS a penalty payment of \$5,000 per each laborer and mechanic that was not paid a prevailing wage.

However, if the failure to pay prevailing wages was due to intentional disregard of these rules, then the taxpayer must pay to each laborer or mechanic three times the sum of the shortfall, and pay to the IRS a penalty of \$10,000 per laborer and mechanic.

## Apprenticeship Requirements

### Satisfying the Requirements

Projects that do not begin construction on or before January 29, 2023, must comply with the Apprenticeship Requirements to claim the full credit amount. The Notice clarifies that a taxpayer satisfies the Apprenticeship Requirements if the taxpayer satisfies the apprentice labor hours requirement, the apprenticeship participation requirement, and the general recordkeeping requirements. The rules generally pertain to “qualified apprentices,” who are individuals employed by the taxpayer, a contractor or subcontractor and are participating in a registered apprenticeship program.

### Apprentice Labor Hours Requirement

The Notice reiterates the statutory requirement that qualified facilities which begin construction after January 29, 2023 are required to ensure that the following percentage of all construction, alteration or repair work done on a qualifying facility be performed by qualified apprentices, subject to any applicable requirements for apprentice-to-journeyworker ratios of the Department of Labor or applicable State apprenticeship agency.

Qualified Facility Began Construction	Percentage of Hours Performed by Qualified Apprentices
After January 29, 2023, and before January 1, 2024	12.5%
After December 31, 2023	15%

## Apprentice Participation Requirement

The Notice reiterates the requirement that each taxpayer, contractor or subcontractor that employs four or more individuals to perform construction, alteration or repair work with respect to the construction of the qualified facility must employ one or more qualified apprentices to perform such work. As with the Prevailing Wage Requirements, an individual is “employed” for the purposes of this rule if they perform services in exchange for remuneration, regardless of the characterization as an employee or independent contractor.

## General Recordkeeping

The Notice requires a taxpayer to maintain books of account or records, including books and records for contractors or subcontractors of the taxpayer, as applicable, in sufficient form to establish that the apprentice labor hours requirement and the apprentice participation requirement have been satisfied.

## Good-Faith Effort Exception

The Notice clarifies the procedure necessary for a taxpayer to avail itself of a statutory good faith effort exception. A taxpayer is deemed to satisfy the Apprenticeship Requirements if a taxpayer requests qualified apprentices from a registered apprentice program and either (i) the request has been denied (but the denial is not the result of the refusal by the taxpayer or any contractors or subcontractors to comply with the established standards and requirements of the registered apprentice program, or (ii) the registered apprentice program fails to respond to the request within five business days after the date they received it. The Notice provides links to the Office of Apprenticeship’s partner finder tool, though the Notice leaves unaddressed many pressing questions, including a taxpayer’s obligation to request apprentices where a registered apprenticeship program is not located within any reasonable distance from the taxpayer’s project. A taxpayer may rely on the good faith effort exception only if the taxpayer maintains sufficient records documenting the request for qualified apprentices and the denial or non-response, as applicable. It is unclear what recordkeeping will be sufficient to document non-response.

## Key Takeaways

Under the IRA, projects that do not satisfy the Prevailing Wage and Apprenticeship Requirements are eligible for only 20% of the tax credits for which they would otherwise qualify. To avoid the application of these requirements, the construction of a project must begin on or before January 29, 2023, which a taxpayer may demonstrate by satisfying either the Physical Work Test or the Five Percent Safe Harbor, as well as the applicable continuity requirement. The Notice further clarifies that many of the concepts surrounding the Prevailing Wage and Apprenticeship Requirements follow the well-established principles of the Davis-Bacon Act. However, the Notice leaves open many questions, including those addressed by taxpayers in comment letters, around the application of these rules to real world clean energy projects. The Notice states that the IRS intends to issue further guidance, as well as proposed regulations, addressing many aspects of the Prevailing Wage and Apprenticeship Requirements.

Latham & Watkins will continue to monitor and report on developments related to the clean energy tax credits.

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**Endnotes**

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<sup>1</sup> It is not entirely clear how the IRS has determined that January 30, 2023 is the date that is 60 days after the Treasury Department issued the Notice. The Notice was published in the Federal Register on November 30, 2022, which would seem to result in the 60-day period ending on January 29, 2023.

<sup>2</sup> The Notice also confirms that similar principles to those under the Beginning of Construction Notices will apply for new tax credits under the IRA that are subject to the Prevailing Wage and Apprenticeship Requirements.