

IRS Issues Initial Rules for Domestic Content Bonus Tax Credits

IRS Notice explains how a renewable energy project may qualify for bonus tax credits by using American-made components.

Key Points:

- All project components made primarily of steel or iron that perform a structural function in a project must be made from US-manufactured steel or iron.
- Products manufactured in the US that contain some non-US manufactured components may count only the cost of the US-manufactured components as domestic costs.
- Developers will need to obtain cost certifications from their vendors to ensure compliance with the domestic content rules.
- Project developers may rely on a safe harbor list to categorize certain components of wind, solar, and battery projects when applying the domestic content rules.

On May 12, 2023, the IRS published Notice 2023-38 (the Notice), which provides initial guidance clarifying the requirements for claiming domestic content bonus tax credits for renewable energy projects. The bonus tax credits were issued as part of the Inflation Reduction Act of 2022 (the IRA) and are intended to incentivize developers to use American-made steel, iron, and manufactured components to build their projects. The Notice borrows heavily from the “Buy America” rules that were developed by the Federal Transit Administration for contractors who build transportation infrastructure for the federal government. The Notice explains how to comply with the two principal domestic content requirements in the IRA: (i) all steel or iron in a project must be manufactured in the US, and (ii) a specified percentage of the manufactured products in a project must be US-manufactured (the Domestic Content Requirement).

Domestic Content

The IRA provides an additional tax credit for projects placed in service in 2023 or later that satisfy the Domestic Content Requirement. If the Domestic Content Requirement is met, projects claiming an investment tax credit (ITC) can claim up to an additional 10% ITC, while projects claiming a production tax credit (PTC) may increase their PTCs by 10%. Retrofitted projects that qualify as newly placed in service for tax purposes may also qualify for these additional tax credits if the new property incorporated into the project satisfies the Domestic Content Requirement.

Under the IRA, the Domestic Content Requirement is satisfied if: (i) any steel or iron that is a component of the project is manufactured in the US (other than metallurgical processes involving refinement of steel additives) (the Steel or Iron Requirement), and (ii) a minimum percentage of the direct costs of manufactured products are attributable to US-manufactured products or components (the Adjusted Percentage Test). For offshore wind projects, the minimum percentage is 20%, while onshore wind, battery storage, and solar energy projects are generally subject to a minimum percentage of 40%. Both the Steel or Iron Requirement and the Adjusted Percentage Test must be satisfied for the project to qualify for bonus tax credits.

As an initial matter, the taxpayer must identify all “applicable project components” incorporated into the project. Applicable project components are divided into two buckets: (i) those that are manufactured products, and (ii) those made primarily of steel or iron and designed to perform a structural function in the project. The first set of applicable project components must meet the Adjusted Percentage Test, while the latter group must satisfy the Steel or Iron Requirement. Steel and iron included in manufactured products subject to the Adjusted Percentage Test are not subject to the Steel or Iron Requirement.

The Notice includes a non-exhaustive list of applicable project components incorporated into utility-scale solar, onshore wind, offshore wind, and battery storage projects, as well as their classification as either manufactured products or steel/iron products. See Figure 2, at the end of this Client Alert, for this table of applicable project components.

Notably, towers for wind turbines are subject to the Steel or Iron Requirement, while wind tower flanges — a product that the renewables industry noted in its comments is typically produced outside the US — are a manufactured product subject to the Adjusted Percentage Test. This distinction is likely intended to ease the qualification of wind projects for bonus tax credits.

Figure 1, included at the end of this Client Alert, illustrates the process for determining whether a project satisfies the Domestic Content Requirement.

Steel or Iron Requirement

A project satisfies the Steel or Iron Requirement if all manufacturing processes (excluding metallurgical processes involving the refinement of steel additives) for structural components primarily made out of steel or iron occur in the US. The location where the iron ore or steel additives are extracted is irrelevant; only the location where the manufacturing processes occur is of consequence. The Steel or Iron Requirement only applies to construction materials that will be directly incorporated in the project and that serve a structural function. It does not apply to steel or iron incorporated into manufactured products subject to the Adjusted Percentage Test, such as nuts, bolts, screws, fittings, tie wire, hinges, etc.

There is no de minimis exception to the Steel or Iron Requirement. If any of the manufacturing processes (other than the metallurgical processes noted above) for any item that is primarily steel or iron and structural in function occurs outside the US, the project will fail the Domestic Content Requirement.

Manufactured Products

The Notice identifies three key steps necessary to apply the Adjusted Percentage Test:

1. Identify all the “manufactured products” in the project. Under the Notice, a manufactured product is an item produced as a result of a manufacturing process.

2. Identify the “manufactured product components” that comprise the manufactured product. A manufactured product component is an article, material, or supply that is directly incorporated into a manufactured product — i.e., a manufactured product is generally comprised of one or more manufactured product components, although some manufactured products may have no manufactured product components.
3. Determine whether a manufactured product is a “U.S. manufactured product.” This is the case if it is manufactured in the US — meaning that all manufacturing processes with respect to the product itself occur in the US — and all of its manufactured product components are mined, produced, or manufactured in the US. If a manufactured product contains any manufactured product component that is not mined, produced, or manufactured in the US, it is considered to be a “non-U.S. manufactured product,” although any of its manufactured product components mined, produced, or manufactured in the US may still be counted toward the Adjusted Percentage Test, regardless of the origin of any subcomponents.

The relevant costs for the Adjusted Percentage Test are the direct material and labor costs (excluding overhead and other indirect costs) of the manufacturer of the product, not the developer or owner of the project. In practice, this means that developers will need to obtain cost certifications from their vendors in order to establish that the Adjusted Percentage Test is satisfied. The costs incurred by the developer in (i) purchasing the manufactured products from the manufacturer and (ii) incorporating the manufactured products into the project are not factored into this test.

As part of the Notice, the IRS published a table (included at the end of this Client Alert) that categorizes certain manufactured products and their associated manufactured product components based on project type. The IRS may supplement this list or publish additional lists of manufactured products and components for other types of projects in forthcoming proposed regulations pertaining to the domestic content rules.

After determining the origin and direct costs associated with each manufactured product incorporated into a project and its corresponding manufactured product components, the taxpayer may calculate whether the Adjusted Percentage Test has been achieved. The direct costs paid or incurred with respect to (i) U.S. manufactured products, and (ii) manufactured product components mined, produced, or manufactured in the US incorporated into non-U.S. manufactured products, in each case, are included in the numerator, while the direct costs associated with all manufactured products and their manufactured product components are included in the denominator. If the resulting percentage meets or exceeds the applicable minimum percentage (generally 20% for offshore wind, 40% otherwise), the Adjusted Percentage Test has been satisfied.

The application of the Adjusted Percentage Test may be illustrated by the following example for a battery storage project:

Manufactured Product	Manufactured Product Component	Origin	Material / Labor Cost
Inverter	N/A	US	100
Battery Pack	Cells	US	200
	Packaging	Non-US	50
	Thermal Management System	Non-US	150
	Battery Management System	US	100
	(Battery Pack Assembly Costs)	US	100
Battery Container	N/A	Non-US	50
Total			750

The total costs for manufactured products is \$750. The inverter is a U.S. manufactured product because it is manufactured in the US, and it does not have any manufactured product components. The battery container is not a U.S. manufactured product because it is manufactured outside the US. While the battery pack is manufactured in the United States, it is not a U.S. manufactured product because two of its manufactured product components — the packaging and thermal management system — were manufactured outside the US. As a result, the costs of those components and the battery pack manufacturer's assembly costs are not domestic costs. However, the costs of the cells and battery management system are included in the numerator of the Adjusted Percentage Test because those components are manufactured in the US. Accordingly, the Adjusted Percentage Test is satisfied because 400 of the 750 of costs (~53.3%) are attributable to U.S. manufactured products (inverter) or manufactured product components of non-U.S. manufactured products (cells, battery management system), exceeding the minimum percentage (40% for battery storage projects).

Certification

In order to claim domestic content bonus tax credits for a project, the taxpayer must attach a certification to its tax return for the year that the project is placed in service, and for each subsequent year in which it claims the domestic content bonus tax credits (i.e., each of the following 10 years for PTC projects). The certification must provide that, as of the date the project was placed in service, the Steel or Iron Requirement and the Adjusted Percentage Test were satisfied. The statement must be signed under penalty of perjury by a person with legal authority to bind the taxpayer.

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Figure 1: Domestic Content Requirement Flowchart

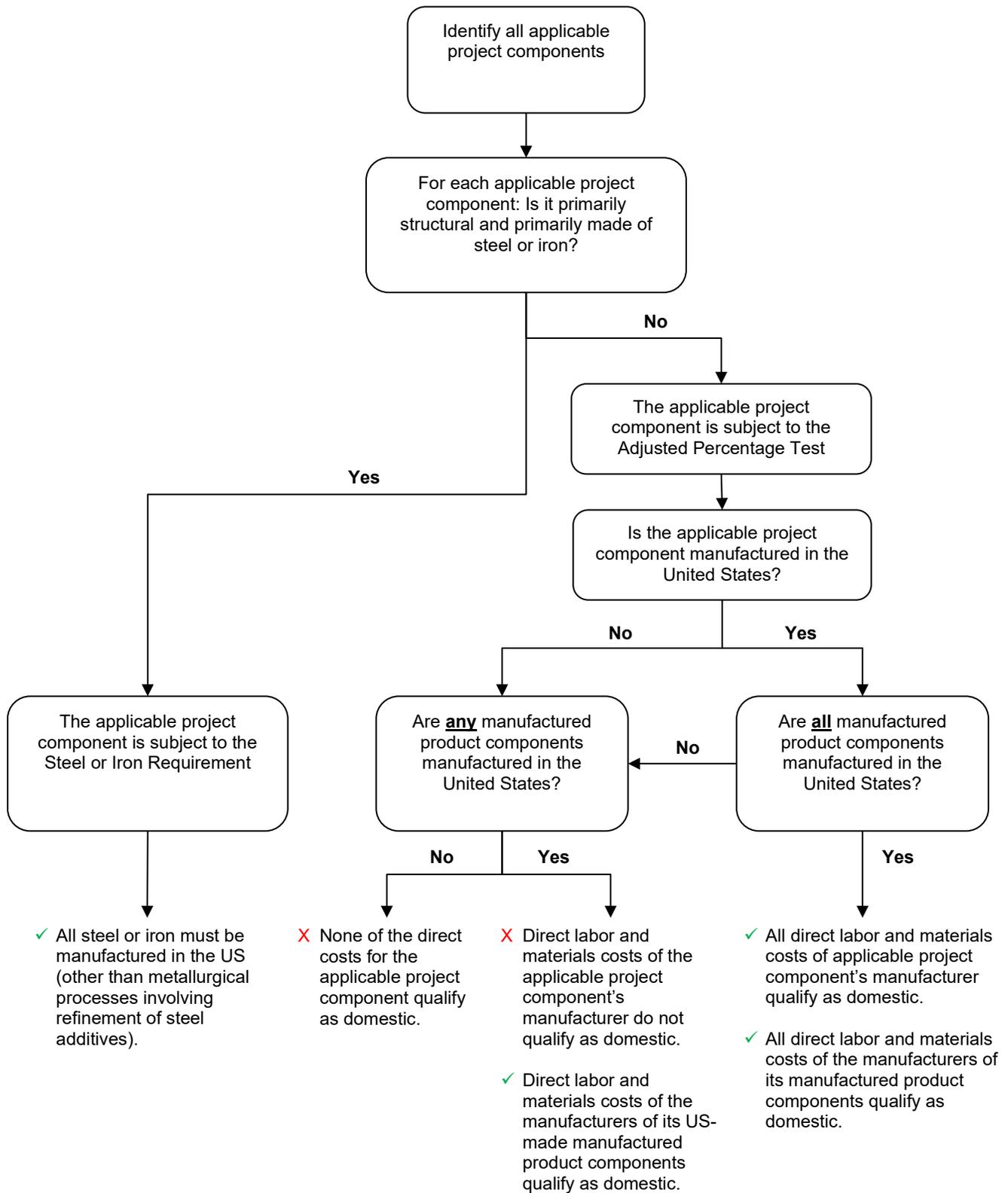


Figure 2: IRS Table of Applicable Project Components

Applicable Project	Applicable Project Component	Categorization
Utility-scale photovoltaic system	Steel photovoltaic module racking	Steel/Iron
	Pile or ground screw	Steel/Iron
	Steel or iron rebar in foundation (e.g., concrete pad)	Steel/Iron
	Photovoltaic tracker	Manufactured Product
	Photovoltaic module (which includes the following manufactured product components, if applicable: photovoltaic cells, mounting frame or backrail, glass, encapsulant, backsheet, junction box (including pigtails and connectors), edge seals, pottants, adhesives, bus ribbons, and bypass diodes)	Manufactured Product
	Inverter	Manufactured Product
Land-based wind facility	Tower	Steel/Iron
	Steel or iron rebar in foundation (e.g., spread footing)	Steel/Iron
	Wind turbine (which includes the following Manufactured Product Components, if applicable: the nacelle, blades, rotor hub, and power converter)	Manufactured Product
	Wind tower flanges	Manufactured Product
Offshore wind facility	Tower	Steel/Iron
	Jacket foundation	Steel/Iron
	Wind tower flanges	Manufactured Product
	Wind turbine (which includes the following manufactured product components, if applicable: the nacelle, blades, rotor hub, and power converter)	Manufactured Product
	Transition piece	Manufactured Product
	Monopile	Manufactured Product
	Inter-array cable	Manufactured Product
	Offshore substation	Manufactured Product
	Export cable	Manufactured Product
Battery energy storage technology	Steel or iron rebar in foundation (e.g., concrete pad)	Steel/Iron
	Battery pack (which includes the following manufactured product components, if applicable: cells, packaging, thermal management system, and battery management system)	Manufactured Product
	Battery container/housing	Manufactured Product
	Inverter	Manufactured Product