

Biden Admin. Proposals Both Encourage And Thwart EV Adoption

By **Levi McAllister** (April 19, 2023, 5:36 PM EDT)

The Biden administration has been focused on an expansive and holistic plan to promote the development and adoption of electric vehicles, and more broadly, clean vehicles, from its earliest days in office. In August 2021, the White House announced its goal that EVs should make up 50% of all vehicles sold in the U.S. by 2030.

The administration subsequently pushed for the passage of the Infrastructure Investment and Jobs Act, or IIJA, which invests \$7.5 billion to build a national network of 500,000 EV chargers; the Inflation Reduction Act, which provides incentives for buyers of new and used EVs; and the CHIPS and Science Act, which encourages domestic production of the semiconductors necessary for EVs.



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However, implementation of these initiatives has not been entirely seamless. In working to implement its policy goals and statutory mandates, the administration has issued proposed guidance documents and rulemakings that simultaneously encourage more aggressive development of EVs and other clean vehicles, while also introducing friction and tension for those that are manufacturing and purchasing the vehicles.

Indeed, the sense of implementation whiplash is best illustrated by contrasting proposed guidance from the U.S. Department of the Treasury, issued March 31, with proposed emissions standards from the U.S. Environmental Protection Agency, announced April 12.

EPA Proposed Emission Standards

Last week, the EPA proposed the most aggressive federal vehicle emissions standards to date, which would subject passenger cars, as well as medium-duty and heavy-duty vehicles, to new pollution limits in an effort to accelerate the transition to clean vehicles.

To be sure, the proposed standards do not mandate zero-emission vehicles. Instead, they propose emission targets based on grams per mile, thereby allowing manufacturers discretion in determining how to comply.

If the proposed standards are finalized and withstand any potential subsequent legal challenges and political amendments, they would produce an industrywide average target of 82 grams of carbon dioxide per mile traveled by 2032. That would be 56% lower than the model year 2026 standard, set in 2021.

For medium-duty vehicles, the proposed standards are looking to increase stringency to a target of 275 grams of CO₂ per mile by model year 2032, which would represent a 44% reduction compared to the model year 2026 standard. For context, the EPA estimated in 2018 that the average light-duty passenger vehicle emits about 404 grams of CO₂ per mile.

If the standards are finalized as proposed, the EPA estimates that EVs will account for 67% of all light-duty vehicle sales by 2032. This reflects a substantial increase from the Biden administration's earlier goal of 50% EV sales by 2030.

Treasury Department Proposed Guidance

The Treasury Department issued long-awaited proposed guidance on March 31 to implement the critical mineral and battery component watershed requirements of the Inflation Reduction Act, which significantly revised the tax credit incentive mechanism of the Internal Revenue Code that relates to EVs.[1]

Since the IRA's enactment, the critical mineral and battery component requirements have generated tremendous interest and comment from virtually all segments of the automotive, mining and component manufacturing industries.[2]

The IRA overhauled Section 30D of the code for qualified plug-in electric drive motor vehicles — including adding fuel-cell vehicles to the Section 30D tax credit; removing a previously existing sales cap; and basing credit eligibility on MSRP recommendations, purchaser income thresholds, final assembly locations, and critical mineral and battery component sourcing and manufacturing.

The IRA also added a new credit for previously owned clean vehicles under Section 25E, and a new credit for qualified commercial clean vehicles under Section 45W.

On Dec. 29, the Internal Revenue Service and the Treasury released a white paper on the critical mineral and battery component sourcing mandates, providing a look into the anticipated direction of the forthcoming guidance, and the process for determining whether vehicles qualify under those requirements.

Although the white paper itself did not amount to proposed guidance or otherwise carry legally binding authority, it was a first look into how the IRS and the Treasury were thinking of applying some of the provisions that have created concern among many stakeholders.

Its release brought forth more questions from lawmakers and industry participants concerning whether — or the extent to which — the proposed guidance would stray from congressional intent in the IRA. On March 31, we received our answer.

Critical Minerals

The proposed guidance specifies that the application of the critical mineral requirement is consistent with the framework that the Treasury previously released in its December 2022 white paper. The guidance sets forth a proposed three-step process for determining the percentage of the value of the applicable critical minerals in a battery.

First, manufacturers must determine the procurement chain or chains for each applicable critical mineral included in the battery. The guidance specifies that a procurement chain is "a common sequence of extraction, processing, or recycling activities that occur in a common set of locations, concluding in the production of constituent materials."

Second, each procurement chain must be separately evaluated to determine whether critical minerals procured from that chain have been (1) extracted or processed either in the U.S. or in any country with which the U.S. has a free trade agreement in effect; or (2) recycled in North America.

Critical minerals that meet this requirement are deemed qualifying critical minerals. However, the proposed guidance further states that it is applying, for a limited transition period, a 50% value-added test to determine whether the qualifying "critical mineral" definition is satisfied:

[A]n applicable critical mineral would be treated as extracted or processed in the United States, or in any country with which the United States has a free trade agreement in effect, if: (1) 50 percent or more of the value added to the applicable 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 applicable 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.

Third, the manufacturer must calculate the percentage of the value of qualifying critical minerals contained in a battery.

Constituent Materials

Importantly, the proposed guidance retains the white paper's proposal that "constituent materials" fall within the critical mineral requirement.

In the months after the white paper's issuance, this classification was the subject of significant debate among industry participants. Some industry participants argue that it amounts to a loophole in the IRA that would allow anode and cathode materials to be sourced from foreign countries rather than in the U.S. — thereby driving foreign competition for U.S. manufacturers.

Free Trade Agreements

Of equal importance, the proposed guidance offers four criteria for determining whether the U.S. has a "free trade agreement" in effect with another nation — a term that is otherwise undefined in the IRA or the Internal Revenue Code:

[A]n 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: (A) reduces or eliminates trade barriers on a preferential basis, (B) commits the parties to refrain from imposing new trade barriers, (C) establishes high-standard disciplines in key areas affecting trade (such as core labor and environmental protections), and/or (D) reduces or eliminates restrictions on exports or commits the parties to refrain from imposing such restrictions on exports.

The proposed guidance specifically identifies the following nations as currently meeting these criteria: Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala,

Honduras, Israel, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru and Singapore — and possibly Japan.

Battery Components

Consistent with the framework that the Treasury previously released in the white paper, the proposed guidance sets forth a four-step process that manufacturers must take in determining the percentage of the value of the applicable battery components in a battery.

First, manufacturers must determine whether each component in a battery was manufactured or assembled in North America. Under the proposed regulations, this is defined as:

[A] battery component for which substantially all of the manufacturing or assembly of which occurs in North America, without regard to the location of the manufacturing or assembly activities of the components that make up the particular battery component.

Second, manufacturers must determine the incremental value for each battery component. Third, manufacturers must total the incremental value of the battery components.

Fourth, manufacturers must determine the "qualifying battery component content" — 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.

Effectiveness and Potential Impact on the EV Market

Taken together, these two issuances potentially serve to both encourage and frustrate EV development and deployment in U.S. markets. More importantly, these issuances raise numerous questions about the practicality and feasibility of achieving the administration's goals.

First, the EPA proposal raises an immediate question as to whether such aggressive targets are possible within the time frame that the agency is mandating for auto manufacturer compliance. The proposal appears to give short shrift to some of the serious charging station infrastructure and supply chain issues plaguing U.S. markets presently.

The EPA's proposal addresses in detail the various federal monetary incentives provided for EVs through the IRA and the IIJA, and leaves the casual reader with an impression that the U.S. currently has a robust, vibrant and reliable public charging station network that is ready and willing to accommodate as many EVs as manufacturers can produce.

As market participants and consumers know all too well, of course, that is simply not the case. Lack of readily available charging stations plagues most regions of the U.S. And while IIJA funding opportunities are slowly becoming available, that is a five-year process that will still be ongoing when the EPA standards are due to take effect.

Those funds are intended to support development of only 500,000 public chargers — which is substantially below what many analysts estimate the U.S. will require to accommodate widespread and aggressive EV deployment. And, once the network is developed, issues still remain concerning the reliability of those stations, as well as their commercial success in a world where utility demand charges threaten the economics of such projects.[3]

Second, the IRA's critical mineral and battery component requirements further serve to frustrate development. Those requirements take effect when the proposed guidance is published in the Federal Register.

From a practical perspective, this means that vehicles placed in service after April 17 must comply with the requirements if the purchaser-taxpayer intends to claim any portion of the clean vehicle tax credit permitted under the IRA's revision to the Internal Revenue Code. But it also means we are now in a situation where a vehicle that qualified for the credit on April 16 may not qualify after April 17.

Many consumers who were considering purchasing an EV may want to have made that purchase before April 17 — or may want to make sure that the model is going to qualify for the tax credit based on whatever list does ultimately come out. But that list is not expected until later this month.

And, given the escalating nature of the critical mineral requirements, automobiles that qualify in 2024 may not qualify in 2025 or 2026, depending on the composition of the battery components and minerals with respect to statutory requirements. This adds a layer of complexity for the consumer from a guidance that was meant to provide more clarity.

While the Treasury's proposal is an attempt at threading the needle in balancing various stakeholder interests, it is very complex — perhaps more than it should be — from the perspective of the consumer. Most car buyers do not consult a tax lawyer before purchasing a vehicle.

Third, auto manufacturers and consumers are still awaiting guidance on the IRA's provisions concerning transferability of tax credits, as well as the foreign-entity-of-concern provision. Absent such guidance, consumers are unlikely to be aggressively pursuing EV purchases in May if they cannot realize a tax benefit until the following April 15 tax filing.

Similarly, auto manufacturers are placed in a bit of a holding pattern when considering corporate formation issues in connection with battery manufacturing and mineral processing functions that might otherwise trigger the foreign-entity-of-concern prohibition.

Ultimately, the U.S. is in a very exciting period of transition in the vehicular transportation industry. Never before have we had so much support from state and federal policymakers for the clean vehicle transition. As the EPA proposal makes clear in its background explanations, the Biden administration has deployed many tools from its toolkit to encourage EV deployment.

Nevertheless, implementation is proving rocky — and introduces the potential to chill consumer appetite for EV purchases in the near term, and frustrate manufacturers' ability to comply in a way that introduces tax-credit-eligible vehicles to market.

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[1] <https://public-inspection.federalregister.gov/2023-06822.pdf>.

[2] <https://www.morganlewis.com/topics/inflation-reduction-act-of-2022>.

[3] <https://www.autonews.com/mobility-report-newsletter/jd-power-ev-charger-reliability-worsens>.