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Industry Takeaways From IRS Guidance On EV Tax Credits

By **Levi McAllister** (January 13, 2023, 5:45 PM EST)

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Many people spent the last week of 2022 celebrating holidays or seeking travel adventures both far and near.

However, a select group of personnel at the Internal Revenue Service and the U.S. Department of the Treasury opted for a different path.

On Dec. 29, 2022, the IRS and Treasury issued several documents providing information and clarification on issues concerning tax credit eligibility for purchases of clean vehicles beginning in January 2023.

There are three important takeaways for the electric vehicle industry in determining tax credit eligibility, including the critical importance of the in-service date of a purchased vehicle, guidance on how leased vehicles could be evaluated, and insight into EV batteries and components manufacturing requirements.

Background

Under the Inflation Reduction Act, Congress significantly revised the tax credit incentive mechanism of the Internal Revenue Code that relates to EVs.

Prior to the IRA, the Internal Revenue Code provided purchasers of new EVs with a tax credit of up to $7,500 so long as the manufacturer of the EV purchased had not triggered a 200,000 unit sales cap at which point the tax credit was no longer available.

The IRA overhauled the Internal Revenue Code in several important respects. The IRA expanded tax credits to clean vehicles, encompassing both qualified plug-in electric drive motor vehicles and fuel cell vehicles — thereby affirming the administration's commitment to both EV and hydrogen technology deployment in U.S. markets.

Under the Section 30D tax credit provisions available to individual purchasers of new vehicles, the IRA removed the previously mentioned sales cap and reformulated eligibility provisions so that tax credit eligibility turns on the purchased vehicle's manufacturer's suggested retail price recommendation, the purchaser's adjusted gross income, 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 of the Internal Revenue Code and a new credit for qualified commercial clean vehicles under Section 45W of the Internal Revenue Code.

IRS and Treasury Guidance Issuances

The implementation of many of the IRA's revisions was left opaque in the statutory text.

For that reason, in preparation for many of those new revisions taking effect in 2023, the IRS and Treasury issued four documents that provide numerous clarifications and explanations for consumers and manufacturers in how EV tax credit eligibility provisions will be applied.

First, the IRS and Treasury issued FAQs for consumers discussing the clean vehicle tax credit provisions and addressing some of the most widely discussed topics of interest since the IRA's enactment in August.

The FAQ and its guidance are not legally binding, but the IRS specifies that taxpayers may avoid any applicable penalties that might otherwise be assessed for credits that are erroneously claimed based on a good faith reliance on the FAQ's guidance.

The FAQs are instructive on numerous fronts — particularly on questions concerning how purchase versus delivery dates will factor into credit eligibility, how Section 45W's commercial vehicle credit will operate, and how and when MSRP, income and sourcing requirements will take effect.

Second, the IRS and Treasury issued a notice providing a safe harbor concerning the computation of incremental cost for purposes of determining credit eligibility amounts under Section 45W's commercial clean vehicle credit.

Under the safe harbor, the IRS and Treasury will accept a taxpayer's use of $7,500 as the incremental cost for all street vehicles — other than compact car plug-in hybrid electric vehicles — with a gross vehicle weight rating of less than 14,000 pounds.

Third, the IRS and Treasury issued a notice of intent to issue regulations concerning the final assembly requirement, MSRP threshold requirement, and vehicle classification terms used in the revised Section 30D of the Internal Revenue Code.

That notice specifies how the IRS and Treasury intend to interpret some of those definitional terms, as well as others, which is a relevant data point for understanding the mechanics of how Section 30D's credit eligibility provisions will apply.

Finally, the IRS and Treasury released a white paper on one of the most widely discussed issues arising in the overhauled Section 30D: the critical mineral and battery component sourcing mandates.

That white paper is designed to provide a look into the anticipated direction of the IRS and Treasury's upcoming proposed guidance on the critical minerals and battery components requirements and the process for determining whether vehicles qualify under those requirements. The white paper itself does not amount to proposed guidance or otherwise carry legally binding authority.

However, it is the first look into how the IRS and Treasury are thinking of applying some provisions that have created concern among many, including whether or how compliance can be achieved given the current — albeit rapidly evolving — landscape of mineral and component processing and manufacturing capability in the U.S.

The IRS and Treasury intend to issue proposed guidance regarding the critical mineral and battery component requirements in March.

Those requirements and certification obligations by qualified manufacturers take effect only after the IRS and Treasury issue proposed guidance, and the IRS and Treasury will expressly identify when such proposed guidance is issued.

Takeaways

Collectively, the IRS and Treasury's issuances have important implications and lessons for EV manufacturers, EV battery and battery component manufacturers, and EV consumers.

Although there is still work to be done to crystallize precisely how some provisions of the IRA's tax credits will be applied — such as Section 30D's sourcing requirements — the issued guidance and clarifications provide meaningful instruction to the market in numerous respects. Below are just three.

First, the IRS and Treasury's FAQ document underscores for consumers and manufacturers alike that a critical trigger for determining credit eligibility is the in-service date of a purchased vehicle, i.e., the date the vehicle was delivered to the purchaser.

This clarification is presently important because both manufacturer MSRP and purchaser income thresholds took effect on Jan. 1, 2022, thereby rendering vehicles exceeding the MSRP threshold or purchases by consumers exceeding the income threshold ineligible for the credits in 2023.

To the extent a consumer entered into a contractual arrangement for a purchase in 2022 but did not take delivery of the vehicle until 2023, the FAQ document advises that the MSRP and income thresholds will apply for purposes of determining credit eligibility.

Second, the issuances also provide important clarification to several components of the Section 45W commercial vehicle credit.

IRS and Treasury guidance makes clear that entities leasing vehicles to a lessee may be eligible for a tax credit if the entity-lessor is deemed to be the owner of the vehicle, i.e., if the lease is not of a character as to amount to a transfer of ownership.

The FAQ also explicitly states that the commercial clean vehicle credit is only available for vehicles that are for a business use, which is not a clear requirement in the statutory text of the IRA but does appear to be indirectly triggered in most, but perhaps not all instances, by a depreciation eligibility qualifying component in the commercial clean vehicle credit.

The safe harbor issuance also provides helpful clarity around the computation of incremental cost and provides claimants with certainty around the use of $7,500 for nearly all light duty instances.

Third, the IRS and Treasury's white paper provides helpful insight for manufacturers of EVs and EV batteries and components into whether and how manufactured products might be able to qualify for credit eligibility.

The intended proposal of three and four-step processes for ascertaining qualifying percentages provides manufacturers a road map to determine whether mineral and component procurement supply chains are adequate to manufacture credit-qualifying EVs.

However, some uncertainty continues to exist because it remains unclear the extent to which critical minerals sourced from non-North American countries will qualify for inclusion in the applicable percentage thresholds.

Although the IRA critical mineral provision would include minerals sourced from countries with whom the U.S. has a free trade agreement, the agencies note that term is undefined in the IRA itself.

As such, the agencies intend to request industry comment on how that provision be applied, which could potentially broaden the inclusion of sourced minerals.

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