

IRS and Treasury Publish Final Regulations for Advanced Manufacturing Production Tax Credits

On October 24, 2024, the United States Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) issued final regulations (the “Final Regulations”) for the Advanced Manufacturing Production Tax Credits under Section 45X of the Internal Revenue Code of 1986, as amended (“45X Credits” and the “Code”). The Final Regulations largely adopt the proposed regulations issued on December 15, 2023 (the “Proposed Regulations”), but the Final Regulations provide several important clarifications and modifications.

The 45X Credits were created under the Inflation Reduction Act of 2022 to incentivize the domestic production of “eligible components” used in the production of clean energy, including solar and wind components, inverters, battery parts and critical minerals. The tax credits are generally available to taxpayers that produce eligible components within the United States or U.S. territories and sell them to unrelated persons.

The 45X Credit is a production tax credit that varies based on the type of eligible component produced. Generally, the production of solar, wind, inverter and battery components generate 45X Credits at a set rate on a per-component and/or per-capacity basis. However, 45X Credits for electrode active materials and applicable critical minerals are calculated as 10% of the cost of production of the applicable eligible component.

Taxpayers may take advantage of 45X Credits for eligible components produced and sold after December 31, 2022. The Final Regulations are generally applicable for tax years ending on or after October 28, 2024. The 45X Credits, except for those generated by the production of applicable critical minerals, will phase out beginning in 2030 at a rate of 25% per year until they are eliminated in 2034.

EXECUTIVE SUMMARY

The Final Regulations largely adopt the Proposed Regulations. We note the following key points:

- Taxpayers can include direct and indirect material costs, as well as domestic extraction costs, in the calculation of production cost for electrode active materials and critical minerals;
- Assembly of components may satisfy the “substantial transformation” requirement, where such assembly is the primary means of production for an eligible component;
- 45X Credits are generally not available for components produced at facilities that qualify for the Advanced Energy Project credit under Section 48C of the Code;
- Eligible components can be sold to related parties if certain conditions are met, and integrated components of eligible components can be deemed to have been sold to an unrelated person; and
- Constituent elements, subcomponents and materials of eligible components may be sourced from outside of the United States.

Inclusion of Extraction and Material Costs for Critical Minerals and Electrode Active Materials

The Proposed Regulations did not allow direct and indirect material costs or extraction costs to be included in the calculation of the taxpayer's production cost.

However, the Final Regulations reversed this approach for applicable critical minerals and electrode active materials. Taxpayers may include direct or indirect material costs in their calculation of production costs, subject to certain conditions, including such costs being directly incurred by the taxpayer claiming the 45X Credit and the satisfaction of extensive substantiation requirements.

The Final Regulations clarify that the material cost of raw materials, sourced domestically or abroad, may be included in the production cost provided that the taxpayer substantially transforms such materials in the United States to produce electrode active materials or critical minerals. Extraction costs may also be included if the extraction occurs in the United States or a U.S. territory. To avoid double-counting, the material costs are included only to the extent that they do not relate to the purchase of materials that were eligible components at the time of purchase.

Because the 45X Credit for these components is calculated as 10% of the taxpayer's production costs, this change significantly expands the scope and magnitude of the 45X Credit, and encourages onshore mineral extraction and manufacturing while allowing flexibility to source raw materials abroad.

Clarification on "Produced by the Taxpayer" and Assembly Limitations

Treasury rejected requests from commenters to use the same "production" definition used in Section 263A of the Code, instead choosing to adopt a broader, more expansive definition of production. This allows for flexibility in production processes, notably for solar and battery module manufacturers, which incorporate pre-existing components into larger assemblies.

The Final Regulations clarify the definition of "produced by the taxpayer" to make the 45X Credit available for taxpayers which produce eligible components through "secondary production", *i.e.*, creating an eligible component using recycled materials.

The Final Regulations also allow assembly to satisfy the "substantial transformation" requirement where assembly is the primary means of production for an eligible component. As noted in the preamble to the Final Regulations, this clarification is particularly relevant for the production of solar or battery modules, which are often produced through the assembly of component parts.

Domestic Production Rule Exceptions for Subcomponents and Constituent Parts

Eligible components must be produced in the United States or a U.S. territory to qualify for the 45X Credit. However, the Final Regulations provide that constituent elements, subcomponents and materials used to produce such eligible components are not subject to the domestic production requirement. Therefore, such constituent elements, subcomponents and materials, including raw materials and intermediate productions, may be sourced from outside the United States. Further, there is no requirement that the eligible components must be sold or used in the United States following production.

This should allow manufacturers with complex supply chains to maintain cost efficiency in materials sourcing while meeting credit eligibility requirements.

Expanded Rules for Related-Party Sales

Generally, taxpayers are only eligible to claim 45X Credits for eligible components that are produced and sold to unrelated persons. However, the Final Regulations allow sales to related persons if certain conditions are met, including transactions where a special "Related Person Election" is made, or the eligible component is sold to a related person who in turn sells the component to an unrelated person. Taxpayers must provide substantial information to the IRS to make a Related Person Election.

The Final Regulations also clarify that integrated components of eligible components can be deemed to have been sold to an unrelated person if a taxpayer produces the eligible component that is integrated, incorporated or assembled into another eligible component that is then sold to unrelated parties.

The expanded rules for related-party sales support integrated production models, allowing companies with intercompany sales to maximize credit

utilization across related business units. However, taxpayers should be prepared to comply with documentation requirements in connection with related-party sales.

Interaction between Sections 45X and 48C

The Final Regulations provide that taxpayers can only claim the 45X Credits for eligible components produced at a “section 45X facility”, provided that no part of the section 45X facility is also included in the qualified investment of a “section 48C facility” (under the Section 48C Advanced Energy Project tax credit). A “section 45X facility” includes only the independently functioning tangible property used by the taxpayer that is necessary to produce the relevant components. Therefore, a taxpayer could receive a Section 48C credit on equipment used to produce a subcomponent, and a 45X Credit on the production of an eligible component that incorporates the subcomponent.

Taxpayers should assess their facility investments to optimize credit eligibility and potentially enhance their capital allocation towards specific clean energy projects.

Technical Clarifications on Eligible Components

The Final Regulations also include several technical clarifications on component definitions, including, among others, solar-grade polysilicon, inverters, offshore wind vessels and the configuration requirements for battery modules. However, with respect to the definition of aluminum, Treasury and the IRS have determined that additional consideration is necessary prior to finalizing the relevant definition.

These updates streamline component eligibility, which is particularly beneficial for the battery and solar sectors, as the clarifications align product specifications with regulatory requirements to reduce ambiguities that could hinder credit claims.

Conclusion

The Final Regulations provide critical updates, enhancing credit availability for taxpayers engaged in clean energy manufacturing. By allowing extraction costs for critical minerals, clarifying definitions and supporting integrated supply chains, the regulations make the 45X Credit a viable, substantial incentive for domestic production. Taxpayers can leverage these benefits to optimize tax credits while aligning with national energy security and sustainability goals.

NEW YORK

Lauren Angelilli
+1-212-474-1016
langelilli@cravath.com

Christopher K. Fargo
+1-212-474-1236
cfargo@cravath.com

Andrew C. Compton
+1-212-474-1222
acompton@cravath.com

Will Kim
+1-212-474-1362
wkim@cravath.com

April M. Kent
+1-212-474-1116
akent@cravath.com

CRAVATH, SWAINE & MOORE LLP

NEW YORK

Two Manhattan West
375 Ninth Avenue
New York, NY 10001
+1-212-474-1000

LONDON

CityPoint
One Ropemaker Street
London EC2Y 9HR
+44-20-7453-1000

WASHINGTON, D.C.

1601 K Street NW
Washington, D.C. 20006-1682
+1-202-869-7700

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