

Insights

THE NEW DOMESTIC CONTENT BONUS CREDIT AND NOTICE 2023-38

THE INFLATION REDUCTION ACT OF 2022

Jun 08, 2023

SUMMARY

The Inflation Reduction Act of 2022 (the “IRA”) made significant changes to expand and restructure the renewable energy incentives provided by the Production Tax Credit (the “PTC”) under Section 45 of the Internal Revenue Code (the “Code”),^[1] and the Investment Tax Credit under Section 48 (the “ITC”) of the Code.^[2] Among the changes are the addition of “bonus” credits designed to influence how renewable energy credits are implemented. The bonus credits include a “domestic content” bonus credit for projects that are placed in service after December 31, 2022, and for which all steel and iron and a specified percentage of manufactured products included in the project are produced in the United States. This Insight discusses the new domestic content bonus credit, including recent Internal Revenue Service (“IRS”) guidance provided by Notice 2023-38.

BACKGROUND

The domestic content bonus credit is available both for the modified PTC under Section 45 and the modified ITC under Section 48, each of which generally continues to apply for projects placed in service prior to January 1, 2025, and for the new technology-neutral zero-emission PTC and ITC provisions under Sections 45Y and 48E, which will generally apply to projects placed in service after December 31, 2024.

Generally, for projects that satisfy or are exempt from new prevailing wage and apprenticeship requirements (the “PWA Requirements”), the PTC domestic content bonus credit is 10% of the credit otherwise available, and the ITC domestic content bonus credit is a 10 percentage point increase in the ITC credit percentage. For example, if the PTC otherwise available for a project is based upon a credit rate of 1.5 cents per kWh, the credit rate would be increased to 1.65 cents per kWh if the project satisfies the domestic content requirements (in each case subject to an inflation adjustment). Similarly, the credit rate for an ITC project that satisfies the domestic content

requirements would increase from 30% to 40%.^[3] Generally, to obtain the domestic content bonus credit, the taxpayer must timely certify that the domestic content requirements are satisfied.

NOTICE 2023-38

On May 12, 2023, the IRS issued Notice 2023-38 (the “Notice”), which announced the intent to issue proposed regulations to address the domestic content requirements and, which provides initial guidance on how taxpayers can qualify for the domestic content bonus credits. In addition, the Notice:

- Announces that the proposed regulations will apply to taxable years ending after May 12, 2023.
- Provides that taxpayers may rely on the rules set forth in the Notice for qualifying projects for which the taxpayer commenced construction prior to mid-August, 2023.
- Provides a safe harbor for determining the nature of certain project components typically found in utility-scale renewable energy projects.

A project will qualify for the domestic content bonus if it meets the following requirements: (i) 100% of the iron and steel components that are structural in nature are produced and manufactured in the United States, (the “Steel and Iron Requirement”), and (ii) a specified percentage (determined by cost) of all manufactured products used to construct a project are, or deemed to be, produced, mined, or manufactured in the United States (the “Adjusted Percentage Rule”). Under section 45, for projects placed in service after December 31, 2022, the percentage is 40% for projects other than offshore wind projects, and 20% for offshore wind projects. Under Section 45Y, the percentage increases to 45% for projects for which construction starts during 2025, 50% for projects for which construction starts in 2026, and 55% for projects for which construction starts after 2026.

To conduct a domestic content analysis, taxpayers will need to determine which project components are “applicable project components,” and where each component is produced. The applicable project components can then be broken into two groups:

1. components made primarily of steel or iron that are structural in nature, and
2. manufactured products.

For this purpose, products such as nuts, bolts, clamps, tie wire, etc., are not treated as steel or iron components that are structural in nature. Generally, the Notice provides that determinations about where a component is produced will be based upon sections 661.1 through 661.21 of Title 49 of the Code of Federal Regulations, otherwise known as the Buy America Requirements, as administered by Federal Transit Administration of the Department of Transportation.

To meet the Steel and Iron Requirement, all iron and steel used for structural components must be entirely manufactured in the United States (excluding metallurgical processes involving refinement of steel additives). Components that are subject to the Adjusted Percentage Rule are not subject to the Steel and Iron Requirement. The Notice provides a non-exhaustive safe harbor for identifying the applicable project components typically found in utility-scale photovoltaic systems, land-based wind facilities, offshore wind facilities and battery energy storage technologies. The safe harbor is in the form of a table, which is reproduced below.

The Adjusted Percentage Rule is satisfied if the percentage produced by dividing (a) the aggregate cost of the manufactured products and components made in US factories by (b) the aggregate cost of all manufactured products, equals or exceeds the applicable domestic percentage requirement. The costs of a manufactured product only include direct material and labor costs paid or incurred by the manufacturer of such manufactured component. Neither a project developer's nor owner's cost may be contemplated in the Adjusted Percentage Rule.

A manufactured product is considered produced in the United States if:

- a. all manufacturing processes take place in the United States, and
- b. all manufactured product's components are manufactured in the United States, regardless of the origin of its subcomponents.

Taxpayers claiming the domestic content bonus credit will be required to submit a certification to the IRS with its annual tax return certifying that the domestic content requirements are met for the applicable project for which the credit is being claimed. As such, determining what manufactured products are made in the United States will require a careful analysis of where each component of each manufactured product was manufactured.

The IRS plans to issue domestic content proposed regulations in late 2023 or early 2024.

Exhibit A

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

[1] Unless otherwise indicated, references to “Sections” are to Sections of the Code.

[2] The PTC and ITC changes in the IRA are described in more detail in our SUMMARY OF INFLATION REDUCTION ACT CHANGES TO PRODUCTION TAX CREDIT AND INVESTMENT TAX CREDIT FOR RENEWABLE ENERGY Insight on our website.

[3] If a project is not exempt from, and does not satisfy, the PWA Requirements, the PTC and ITC bonus credit amounts are based upon 2% and 2 percentage point increases, respectively. The PWA Requirements are not discussed here, but are addressed in our Prevailing Wage Analysis Alert. If a project is not exempt from, and does not satisfy, the PWA Requirements, the PTC and ITC bonus credit amounts are based upon 2% and 2 percentage point increases, respectively. The PWA Requirements are not discussed here, but are addressed in our INDUSTRY UPDATE: PWA GUIDANCE Insight on our website.

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