US Inbound Corner

Tax Incentives in the Inflation Reduction Act and the CHIPS Act

In this edition

Inflation Reduction Act of 2022

The IRA was enacted on August 16, 2022. It extends and enhances many existing sustainability-related credits, and adds new tax credits for clean hydrogen, standalone storage property, biogas property, microturbines, microgrid controllers, clean vehicles, the manufacture of certain energy components, among others. It also changes how many credits are calculated and provides multiple new options for taxpayers to utilize the benefits.

Under the IRA, a two-tiered benefit structure is adopted for various incentives described in IRC sections 30C, 45, 45Y, 45L, 45Q, 45V, 45Y, 45Z, 48, 48E, 48C, and 179D (e.g., credits for carbon capture, clean hydrogen production, and renewable electricity generation). Generally, the "base" credit amount is equal to 1/5 of the full statutory credit amount. Taxpayers that satisfy certain prevailing wage and apprenticeship ("labor") requirements for the construction, alteration, or repair of the property or facility qualify for a 5X multiplier to the base amount, resulting in the full "enhanced" credit amount. As a form of transitional relief, these labor requirements are treated as satisfied if construction of the energy project or facility begins prior to January 29, 2023.[1] Accordingly, taxpayers had less than a month into 2023 to establish the beginning of construction on an eligible project or facility (i) by starting physical work of a significant nature ("Physical Work Test"), or (ii) by paying or incurring five percent or more of the total cost of the facility ("5% Safe Harbor") in order to be deemed to satisfy the wage and apprenticeship requirements.[2]

Moreover, the IRA provides additional bonus credit amounts ("adders") for the section 48 investment tax credit ("ITC") and section 45 production tax credit ("PTC") for energy projects and/or facilities the construction of which begins before 2025. The adders also apply to the technology neutral energy credits (e.g., PTC and ITC under IRC sections 45Y and 48E) for energy projects and/or facilities placed in service after 2024. This allows taxpayers to increase their eligible credit amount if they meet domestic content requirements, are located in an energy community, and for select small-scale wind and solar projects that are part of certain in low-income communities. With these credit adders, taxpayers could be eligible for an ITC of 40%, 50%, and even up to 70% in select cases.

Perhaps the most fundamental modification introduced by the IRA is the new options to utilize the certain Federal tax credits during tax years beginning after 2022 under IRC sections 6417 and 6418. Under IRC section 6417, an "applicable entity" (generally tax-exempt organizations and governmental entities) may elect to be treated as having made a payment of tax equal to 100% of the value of the "applicable credit" for the tax year. To the extent that a taxpayer does not have tax liability to offset, the taxpayer would receive a refund. Taxable entities that are engaged in qualifying activities for credits under IRC sections 45Q, 45V, and 45X are treated as an "applicable entity" for a five-year period. Specifically, these taxable entities are eligible to make the direct pay election for the first five tax years beginning on the placed in service date of the qualified facility for the 45Q credit and the 45V credit, and during any consecutive five-year period elected by the taxpayer for the 45X credit.

Additionally, IRC section 6418 allows an "eligible taxpayer" that is not eligible for the direct pay election to instead elect to transfer all or any portion of an "eligible credit" to an unrelated taxpayer (under IRC section 267(b) or 707(b)(1)) for cash consideration. Such consideration is not includible in gross income of the transferor and is not deductible by the transferee. The transferee receiving the credit cannot thereafter transfer it to another entity. The eligible credits in this case refer to those claimed under IRC sections 30C, 45, 45Q, 45U, 45V, 45X, 45Y, 45Z, 48, 48C, and 48E.

IRA Guidance

In October and November 2022, the IRS and Treasury issued nine notices requesting comments on certain topics relating to the IRA from interested parties in order to aid the agency in drafting the guidance items most reflective of the needs of taxpayers entitled to claim energy credits.[3] Since then, the IRS and Treasury has issued guidance related to the development and implementation of the IRA, where comments received in response to prior associated Notices were generally considered in the drafting of the applicable guidance.[4] See below for a summary of select guidance recently issued:

1. Notice 2023-29 (April 4, 2023), provides guidance and certain rules that the IRS intends to include in forthcoming proposed regulations for the energy community adder for an increased credit amount of up to 10%. Specifically, the Notice provides rules for determining what constitutes an energy community under IRC sections 45, 45Y, 48, and 48E, that applies to taxable years ending after April 4, 2023.[5] Furthermore, the IRS and Treasury have partnered with the Interagency Working Groups on Energy Communities to provide a searchable online-based mapping tool to help identify select energy communities, which will be regularly updated as data become available.[6] The Notice provides a special rule for beginning of construction ("BOC") and requests comments by May 4, 2023 addressing the possible data sources, revenue categories, and procedures to determine whether an MSA or non-MSA qualifies under the Statistical Area Category based on Fossil Fuel Tax (defined in the Notice).
2. REG-120080-22 (March 31, 2023), Notice of Proposed Rulemaking ("NRPM"), provides guidance in the form of proposed regulations related to the new clean vehicle critical mineral and battery component requirements under section 30D that will apply to vehicles placed in service after April 18, 2023, the day after the NPRM is issued to the Federal Register. As a result of the guidance, the IRS updated the FAQs (Fact Sheet 2023-08, supersedes FS-2023-04) for clean vehicle credits. [7]

3. Notice 2023-18 (February 13, 2023), establishes the first allocation round for the IRC section 48C Qualifying Advanced Energy Project Credit Program allocating $4 billion of the $10 billion in available credits for qualified advanced energy projects at industrial or manufacturing facilities for the production or recycling of certain property.[8] The 30% tax credit (or 6% if certain prevailing wage and apprenticeship requirements are not met) will be awarded for projects that expand U.S. supply chains for clean energy technologies and critical materials, and for projects that reduce greenhouse gas emissions at industrial facilities. The Notice provides initial program guidance, including general rules for determining the section 48C credit, definitions of qualifying advanced energy projects, and the procedures for allocating the credits. The IRS and Treasury will issue additional guidance by May 31, 2023, to provide more details regarding information applicants will be required to submit to request a credit allocation. The first allocation round concept papers will be accepted from May 31, 2023 through July 31, 2023. The DOE will review submissions and issue a letter to the applicant either encouraging or discouraging the submission of an application for an allocation of 48C credits.

CHIPS Act of 2022

The CHIPS Act was enacted on August 9, 2022 as part of the Supreme Court Security Funding Act of 2022 (P.L. 117-167) and features two massive funding mechanisms for the domestic semiconductor industry: a grant and financing program, the CHIPS Incentive Program, and the Advanced Manufacturing Investment Credit ("48D credit").

CHIPS Incentive Program

The Department of Commerce ("DOC") National Institute of Standards and Technology ("NIST") created the CHIPS Program Office ("CPO") to implement the newly allocated $39 billion CHIPS Incentives Program ($19 billion for fiscal year 2022; and $5 billion each year for 2023 through 2026) to provide direct funding (i.e., grants) and loans or loan guarantees for investments in facilities and equipment for the fabrication, assembly, testing, advanced packaging, production or R&D of semiconductors, materials used to manufacture semiconductors, or semiconductor manufacturing equipment.[9] On February 28, 2023, the CPO released the first round of funding through Notice of Funding Opportunity (NOFO) Number: 2023-NIST-CHIPS-CFF-01, CHIPS Incentives Program – Commercial Fabrication Facilities.[10] This NOFO seeks applications for semiconductor fabrication ("fab") projects involving the construction, expansion, or modernization of fabs, including both front-end wafer fabrication and back-end assembly, testing, and packaging, and is broken down into two parts – (1) leading-edge semiconductor fabrication facilities (rolling submissions will be accepted starting March 31, 2023), and (2) current-generation and mature-node semiconductor fabrication facilities (rolling submission will be accepted starting May 1, 2023).[11] Based on the NOFO, total amount of a CHIPS Incentives Award (direct funding and principal amount of loan/loan guarantee) will not to exceed 35% of project capital expenditures, and the CPO expects most CHIPS Direct Funding awards will range between 5% to 15% of project capital expenditures.[12] These percentages reflect certain assumptions about a project, including debt-to-equity ratios and the contribution of the Investment Tax Credit, which may not apply in all cases.[13] This round of funding does not apply to semiconductor supply chain materials/semiconductor manufacturing equipment, or R&D facilities. The CPO expects to announce two additional funding opportunities relating to these categories in late Spring 2023 and early Fall 2023, respectively.[14]

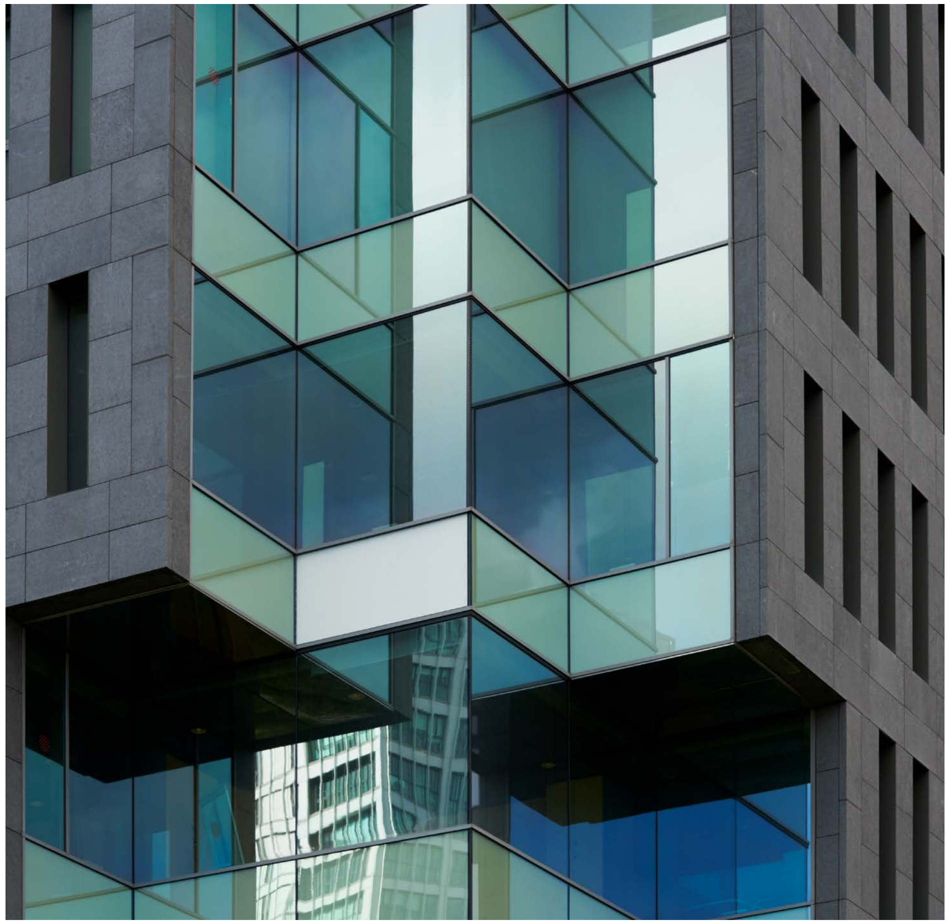
The application process for funding includes the following phases: 1) Statement of Interest, 2) Recommended Pre-application, and 3) Full application.[15] Each component will be accepted/reviewed on a rolling basis. CPO will provide feedback to the applicant at various stages to inform the applicant's decision regarding whether to proceed to the next step in the process and to increase the likelihood of receiving applications that can realize the goals of the CHIPS Incentives Program.[16] In order to submit a pre- or full application, a potential applicant must submit a Statement of Interest with a brief description of the planned application a minimum of 21 days in advance. Statements of Interest are being accepted on a rolling basis beginning on February 28, 2023.[17] CPO recommends all potential applicants submit a Statement of Interest at this time to gauge interest in the program and plan for application review.

Proposed Rule

On March 23, 2023, the DOC NIST issued a proposed rule, Preventing the Improper Use of CHIPS Act Funding which defines certain terms (e.g., "affiliate," "significant transaction," "material expansion," "semiconductor manufacturing," "legacy semiconductors," "predominately serves the market," "existing facilities"), identifies the types of transactions that are prohibited under certain clawbacks (i.e., Expansion Clawback and Technology Clawback), and provides a description of the process for notification of transactions to the DOC Secretary.[18] Under the Expansion Clawback, funding recipients may not engage in any significant transaction involving the material expansion of semiconductor manufacturing capacity in a foreign country of concern. The proposed rule extends this prohibition to the funding recipient's affiliates, to ensure the purpose of the prohibition is not circumvented. This document also requests written comments for consideration in drafting the final regulations by May 22, 2023.

Section 48D Advanced Manufacturing Investment Credit

IRC section 48D provides eligible taxpayers with a 25% federal investment tax credit for qualified investment during a taxable year with respect to an advanced manufacturing facility for semiconductor manufacturing or associated equipment manufacturing, the construction of which begins before January 1, 2027. Qualified investment is the basis of any qualified property (e.g., tangible property integral to the semiconductor manufacturing, including building or structural components) placed in service during the taxable year. Unlike the CHIPS Incentives Program, the investment tax is statutory and is claimed on a taxpayer's federal tax return. It is uncapped (e.g., no maximum credit amount) and there is no application process required. Notably, the 48D credit allows for a direct pay election where the credit can be treated as a payment of taxes, for any taxpayer whether tax-exempt or not.[19] As noted, to the extent that a taxpayer does not have tax liability to offset, the taxpayer would receive a refund.



Proposed Regulations

On March 23, 2023, the IRS and Treasury issued REG-120653-22, Notice of Proposed Rulemaking (NPRM), Advanced Manufacturing Investment Credit addressing credit eligibility requirements, including the definition of "semiconductor" and "semiconductor manufacturing equipment" aligned with the DOC guidance, rules around the direct pay election, a special 10-year credit recapture rule that applies if there is a significant transaction involving the material expansion of semiconductor manufacturing capacity in a foreign country of concern, and a safe harbor for the beginning of construction continuity requirement of 10 years.[20] This document also requests written comments for consideration in drafting the final regulations by May 22, 2023.

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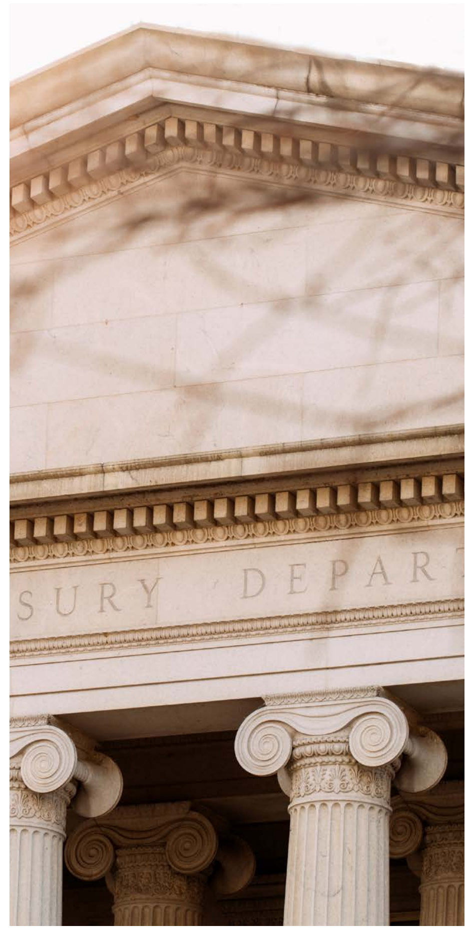
USMCA Dispute Settlement Panel's decision on automotive rules of origin

On 11 January 2023, a five-member arbitral panel ("Panel"), which was established pursuant to Article 31 of the United States-Mexico-Canada Agreement ("USMCA"), made public a Final Report, dated 14 December 2022, that decided the dispute related to the interpretation of the USMCA's automotive rules of origin.

The Panel held that the U.S.'s current application of its interpretation of the rules of origin, prohibiting the practice of "rolling up" regional North American content, was inconsistent with the USMCA. Thus, core parts included in column 1 of Table A.2 of the Appendix to USMCA Chapter 4 ("core parts of Table A.2") that qualify as originating as part of the "super-core" part calculation should also be treated as originating when calculating the Regional Value Content ("RVC") of a finished vehicle.

Companies seeking to manage the impacts, and potential benefits, of the USMCA developments described above, should consider the following:

- **Data Analysis –** Analyze trade data to assess the company's import and export footprint and identify products that are impacted by the USMCA rules of origin;
- **Solicitation and certification –** Solicit origin certifications from suppliers and certificates of origin for finished goods exported within the USMCA region;
- **Origin qualification –** Review product-specific requirements to confirm that goods meet the USMCA rules and may benefit from preferential duty treatment;
- **Duty impact –** Identify potential savings opportunities based on the USMCA rules of origin;
- **FTA processes –** Review potential changes to internal activities related to the solicitation of certifications of origin and origin qualification/certification;
- **Operating model –** Establish a roadmap to define and implement an effective USMCA operating model, such as updates to process flows, work instructions, training materials, etc.
- **Origin verification audit defense –** Identify the documentation that needs to be maintained to support USMCA claims, and develop an origin qualification defense file that traces materials and components used in the production process for use as evidence in an origin verification audit;
- **Origin verification –** Provide support in managing responses to origin verification questionnaires or on-site visits from U.S., Mexican or Canadian customs authorities; and
- **System support –** Support the implementation and maintenance of ERP and Global Trade Management system tools used to qualify goods.



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Calendars to watch

Each edition, be sure to mark your calendars for some of the more important events (recent and upcoming) as well as tax developments making in impact on businesses investing into the United States.

Deloitte Tax Accounting Conference – Orlando, FL

Join us May 22–26 at the Deloitte Tax Accounting Conference 2023 in Orlando. Now in its 18th year, our program will feature onsite, face-to-face courses, keynotes, and breakouts that help tax, accounting, and finance professionals understand and address the latest tax accounting challenges related to ASC 740.

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Endnotes

1. The date that is 60 days after the Treasury Secretary published associated guidance, IRS Notice 2022-61.
2. See IRS Notice 2022-61 which provides guidance on the prevailing wage and apprenticeship requirements that generally apply to certain provisions of the IRC, as amended by the Inflation Reduction Act of 2022.
3. See IRS Notices 2022-46 through 51 and Notices 2022-56 through 58. Comments submitted in response to the Notices, as well as for other guidance requesting comments, can be publicly viewed at www.regulations.gov.
4. *Treasury Releases Guidance to Drive Investments to Coal Communities*, April 4, 2023. Retrieved from home.treasury.gov/news/press-releases/jy1383.
5. There are three categories of energy communities: (1) Brownfield (brownfield sites), (2) Statistical Area (areas that have significant employment (at least 0.17%) or local tax revenues (at least 25%) from fossil fuels and higher than average unemployment at or above the national average for the previous year), and (3) Coal Closure (a census tract or directly adjoining census tract where a coal mine closed after 1999, or where a coal-fired electric generating unit was retired after 2009).
6. U.S. Department of Treasury (2023). *Treasury releases Guidance to Drive Investment to Coal Communities*, April 4, 2023. Retrieved from home.treasury.gov/news/press-releases/jy1383.
7. *IRS updates frequently asked questions related to new, previously owned and qualified commercial clean vehicle credits*, March 2023. Retrieved from www.irs.gov/pub/taxpros/fs-2023-08.pdf.
8. Forty percent of the allocation (i.e., $4 billion of the $10 billion) is reserved for projects located in certain energy communities (a census tract or tracts adjacent to census tracts in which a coal mine has closed after 1999, or a coal-fired electric generation unit has been retired 2009) that did not previously receive a certification and allocation of IRC section 48C credits.

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09. U.S. Department of Commerce (September 6, 2022). "A Strategy for the CHIPS for America Fund." Retrieved from *www.nist.gov/system/files/documents/2022/09/13/CHIPS-for-America-Strategy %28Sept 6%2C 2022%29.pdf*
10. Chips Program Office (February 28, 2023). "Notice of Funding Opportunity, CHIPS Incentives Program – Commercial Fabrication Facilities." Retrieved from https://www.nist.gov/system/files/documents/2023/02/28/CHIPS-Commercial_Fabrication_Facilities_NOFO_0.pdf
11. Id.
12. U.S. Department of Commerce (2023). *Notice of Funding Opportunity Number 2023-NIST-CHIPS-CFF-01*, February 28, 2023. Retrieved from www.nist.gov/system/files/documents/2023/02/28/CHIPS-Commercial_Fabrication_Facilities_NOFO_0.pdf.
13. Id.
14. Id.
15. Id.
16. Id.
17. Id.
18. U.S. Department of Commerce (2023). "Preventing the Improper Use of CHIPS Act Funding", March 23, 2023. Retrieved from www.federalregister.gov/documents/2023/03/23/2023-05869/preventing-the-improper-use-of-chips-act-funding.
19. IRC section 48D(d).
20. U.S. Department of Treasury and Internal Revenue Service (2023). "REG-120653-22, Notice of Proposed Rulemaking, Advanced Manufacturing Investment Credit," March 23, 2023. . Retrieved from www.federalregister.gov/documents/2023/03/23/2023-05871/advanced-manufacturing-investment-credit.

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