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Impact of New IRS Guidance for the Domestic Content Bonus in the Inflation Reduction Act

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On May 12, the Department of Treasury and the Internal Revenue Service (IRS) issued guidance (Notice 2023-38PDF) providing clarity on how taxpayers installing wind, solar, energy storage, and other clean energy projects can receive a ten percent domestic content bonus credit on top of the existing tax credit under the relevant provision. Energy project owners are the recipients of this bonus credit and will have to certify to the IRS that their projects are entitled to the bonus credit. Energy project owners who are able to comply can cut their project costs through the ten percent credit.

Project owners will need information regarding the domestic content of their energy products – wind turbines, solar modules, energy storage systems, etc., – from their manufacturers. Clean energy manufacturers who have significant domestic content in their products may be able to ask for a premium on the product.

It is important to understand how this recent guidance will have real-life business impacts. Our team can help set up your project or product to meet the requirements of this recent guidance and assist with the certification process for the domestic content bonus credit.

Initial Insights:

Determining which costs fall into the categories that the IRS has provided may be challenging. Critically, manufacturers need to assess costs at the "Manufactured Product Components" level and make sure that the manufacturing process is entirely in the U.S. for these components. Manufacturers may find this challenging, as they may not want to hand over the cost of their inputs to their customers.

Clarification of the Domestic Content Bonus Credit:

Starting in 2023, under the Inflation Reduction Act (IRA), certain clean energy projects are eligible for a ten percent bonus credit if they can meet domestic content requirements in their clean energy projects. Additionally, unless domestic content requirements are met, the amount of any elective payment sought by non-profit taxpayers may be limited for IRA credits. These domestic content requirements apply under Sections 45 Production Tax Credit, Section 45Y Clean Energy Production Credit, Section 48 Investment Tax Credit, and 48E Clean Electricity Investment Credit.

To receive the full ten percent value of the domestic content bonus credit, the project must satisfy the IRA's prevailing wage and apprenticeship requirements. Otherwise, the bonus is only two percent.

There are two parts to the domestic content rules: 1) the steel and iron requirement, and 2) the manufactured product requirement.

1. Steel and Iron Requirement:

For purposes of these requirements, products that are primarily steel and iron must be 100 percent produced in the United States. These requirements, like those for manufactured products, are based on the Federal Transit Authority's Buy America Act regulations, citing 49 C.F.R. 661.5. This requirement includes construction materials that are structural in nature, but it does not include steel or iron used in Manufactured Product (below). Notably, all manufacturing processes with respect to any steel or iron products must take place in the U.S., except metallurgical processes involving the refinement of steel additives. Waivers can be sought for this requirement if the steel or iron component is prohibitively expensive when sourced domestically (would increase project costs by more than 25 percent) or cannot be sourced domestically.

2. Manufactured Product Requirement:

This requirement is satisfied if all components that are "manufactured products" are produced in the United States or are deemed to be produced in the United States. A manufactured product is deemed to be produced in the United States if the project meets or exceeds the adjusted percentage for domestic manufacturing. The adjusted percentage is the project's domestic manufactured products and domestic component costs, which includes any domestic article, material, or supply, whether manufactured or unmanufactured, divided by the total manufactured product costs. The adjusted percentages, for all but offshore wind projects, are:

- 40 percent for projects that begin construction before 2025;
- 45 percent for projects that begin construction in 2025;
- 50 percent for projects that begin construction in 2026; and
- 55 percent for projects that begin construction thereafter.

A manufactured product is considered to be produced in the U.S. if:

1. all of the manufacturing processes for the product occurred in the U.S.; and
2. all of its components (manufactured product components) are of U.S. origin, regardless of the origin of its subcomponents. According to the guidance, "manufactured product component" means any article, material, or supply, whether manufactured or unmanufactured, that is directly incorporated into a project.

Determining the percentages requires assessing the origin of manufactured product components and how much each costs. This includes only direct costs that are direct materials and direct labor costs that are paid or incurred by the manufacturer to produce or acquire the component.

Safe Harbor:

The guidance includes a "safe harbor" that identifies certain items as being subject to either the Steel or Iron Requirement or the Manufactured Products Requirement. Please see below for identified items:

Table 2 – Categorization of Applicable Project Components

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
	Steel or iron rebar in foundation (e.g., concrete pad)	Steel/Iron
Battery energy storage technology	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

Certification to the IRS:
The guidance provides further details on the exact requirements for certification and record keeping by the taxpayer (project owner) as needed by the IRS. A taxpayer must certify and keep records to show that a project meets the domestic content requirements as of the date a project is placed in service.

Retrofit Rules:
A project may qualify as originally "placed in service" even though it contains some used property if the fair market value of the used property is not more than 20 percent of the project's total value. The total value of the project is the cost of the new property in addition to the value of the used property.

Future Guidance:
According to the guidance, the IRS intends to include these guidelines in proposed regulations, but those proposed regulations may be adjusted in a final rule. Taxpayers may rely on the rules described in the May 12 guidance to apply to projects that begin construction until 90 days after the date of publication of the forthcoming proposed regulations in the Federal Register. The exact timing of the proposed regulations and final rule is unclear.

If you have any questions or would like more information, please reach out to P. Lee Smith, or a member of Baker Donelson's Government Relations and Public Policy team.