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Final Regulations on Tax Credits for Electric Vehicles: No Time to Relax

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The Treasury finalized regulations for the Clean Vehicle Credit under I.R.C. Section 30D. These regulations are effective July 5, 2024. The Section 30D credit, up to $7,500, applies to new electric or fuel cell vehicles (EVs). Half of the credit ($3,750 per EV) applies to EVs that have an applicable percentage of their critical battery minerals: (i) extracted or processed in the United States or in a country with which the United States has a free trade agreement; or (ii) recycled in North America (the Critical Minerals Requirement). The other half of the credit is available to EVs that have an applicable percentage of their battery components manufactured or assembled in North America (the Battery Component Requirement). On the same day, the Department of Energy (DOE) finalized rules on Foreign Entities of Concern (FEOC). The DOE has published FAQs on FEOC here.

In addition, I.R.C. Section 30D(d)(7) excludes from the definition of "new clean vehicle" any vehicle placed in service after December 31, 2024, with respect to which any of the applicable critical minerals contained in the battery of such vehicle (as described in Section 30D(e)(1)(A)) were extracted, processed, or recycled by a Foreign Entity of Concern (FEOC) (as defined in Section 40207(a)(5) of the Infrastructure Investment and Jobs Act), or any vehicle placed in service after December 31, 2023, with respect to any of the components contained in the Battery of such vehicle were manufactured or assembled by a FEOC.

However, the final regulations do not extend the time period related to the FEOC as requested by commentators given the current Chinese dominance of EV battery manufacturing and mineral sourcing. The effect is to make EVs more expensive until the mineral and battery production supply chains can complete moving away from China.

These regulations incentivize battery manufacturers to locate in North America and promote North American mining of battery minerals. But in the short term, restrictions related to FEOC are slowing EV adoption.

Critical Mineral Requirement

The applicable percentage for the Critical Mineral Requirement increases based on when the vehicle is placed in service. Vehicles placed in service during 2024, 2025, and 2026 have an applicable percentage of 50 percent, 60 percent, and 70 percent respectively. Any vehicle placed in service after December 31, 2026, must have an applicable percentage of 80 percent.

The proposed regulations issued in April 2023 adopted a "50 percent Value Added Test" to determine whether an original equipment manufacturer had met the Critical Mineral Requirement. However, the final regulations adopt a "Traced Qualifying Value Test," which, according to Treasury, is more precise than the 50 percent Value Added Test, however, the 50 percent Value Added Test can be used on a transitional basis until January 1, 2027. By looking to the highest value-added percentage of the three specified activities (extraction, processing, or recycling) for each applicable critical mineral procurement chain, Treasury asserts that the Traced Qualifying Value Test implements the statutory language by requiring that only one of the three specified activities (extractions, processing, or recycling) with respect to an applicable critical mineral occurring in a qualifying place will have the value of an applicable critical mineral, which counts toward satisfying the Critical Minerals Requirement.

Battery Component Requirement

Separate from the Critical Mineral Requirements, the Battery Component Requirements are found under the updated Section 30D(e)(2)(A). Those requirements are satisfied when the percentage of the value of the components contained within the electric battery of a vehicle is equal to or greater than the "applicable percentage." To qualify, these valuable components must be manufactured or assembled in North America. The applicable percentage for the Battery Component Requirement is set forth in Section 30D(e)(2)(B)(i)-(vi) and varies based on when the vehicle is placed in service. Vehicles placed in service in 2024 or 2025 have an applicable percentage of 60 percent. Vehicles placed in service in the years 2026, 2027, and 2028 have applicable percentages of 70 percent, 80 percent, and 90 percent respectively. Any vehicle placed in service after December 31, 2028, must have an applicable percentage of 100 percent.

The final regulations generally adopt the approach of the previously proposed regulations and generally require the manufacturer to: (i) determine whether each battery component in a battery was a "North American battery component"; (ii) determine the incremental value of North American battery components, with "incremental value" meaning the value of that battery component minus the value of the manufactured or assembled components that are contained in the battery component; (iii) determine the "total incremental value of battery components"; and (iv) determine the qualifying battery component content by dividing the total incremental value of North American components by the total incremental value of battery components.

Foreign Entities of Concern (FEOC)

A FEOC is defined as an entity that is "owned by, controlled by, or subject to the jurisdiction or direction of a government of a foreign country that is a covered nation." Covered nations are China, Russia, Iran, and North Korea. Pursuant to the DOE's guidance an entity is considered a FEOC, if it is headquartered, incorporated, or performing relevant activities in a covered nation, if 25 percent or more of its voting rights, board seats, or equity interest are held by the government of a covered nation, or if the entity is effectively controlled by a FEOC through a license or contract with that FEOC as to which components contained in the battery of such vehicles were manufactured or assembled by an FEOC.

Proposed Section 1.30D-6(a) provided definitions for terms relevant to the FEOC Restriction. The final regulation moves these definitions to Section 1.30D-2(b) and includes a new Section 1.30D-6(a) that is a general statement of the FEOC Restriction. Otherwise, the final regulations adopt the structure and framework of proposed Section 1.30D-6.

Prior to the final enactment, several commentators criticized the FEOC restriction and requested that the applicability dates be delayed to give the industry time to reconfigure supply chains. Other commentators noted the restrictions may be problematic for sourcing land-based minerals such as nickel, cobalt, and manganese. However, the final regulations did not adopt these suggestions.

Should you have questions about these regulations, how they impact your business, or have questions generally related to this topic please contact Thomas J. Mahoney Jr. in our Tax Group or P. Lee Smith in our Public Policy Group.

Brock Lavely, a current law clerk who will be starting as a new associate with Baker Donelson later this year, also contributed to this alert.