Energy and Climate Solutions White Paper: Claiming the Domestic Content Bonus Credit under the Inflation Reduction Act of 2022

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I. Executive Summary

This white paper discusses the requirements related to claiming a bonus credit under Sections 45 and 48 of the Internal Revenue Code of 1986, as amended (the "Code") for satisfying the "domestic content requirement" pertaining to certain renewable energy projects. The domestic content bonus credit will be important to the economics of many energy projects, and qualification for the bonus credit depends on several important determinations, including: (1) the direct labor and material costs of producing project components; (2) the location where a project component is considered produced; and (3) the classification of a component or subcomponent as "steel or iron" or a "manufactured product", as discussed below.

Energy projects qualifying for the domestic content bonus credit are generally eligible for an additional 10 percent investment tax credit ("ITC") under Code Section 48, or a 10 percent increase in the rate for the production tax credit ("PTC") under Code Section 45. As investments in energy credit projects are increasing substantially in the wake of the Inflation Reduction Act of 2022 (the "IRA"), the bonus credit for domestic sourcing of project components could provide a meaningful boost to the viability of qualifying projects.

We provide this white paper as a guide for understanding how the domestic content rules function for projects generally. This paper does not provide project specific determinations, as each project will require a detailed analysis of qualifying project components, their costs, and whether the domestic content bonus credit will apply to the project as a whole.

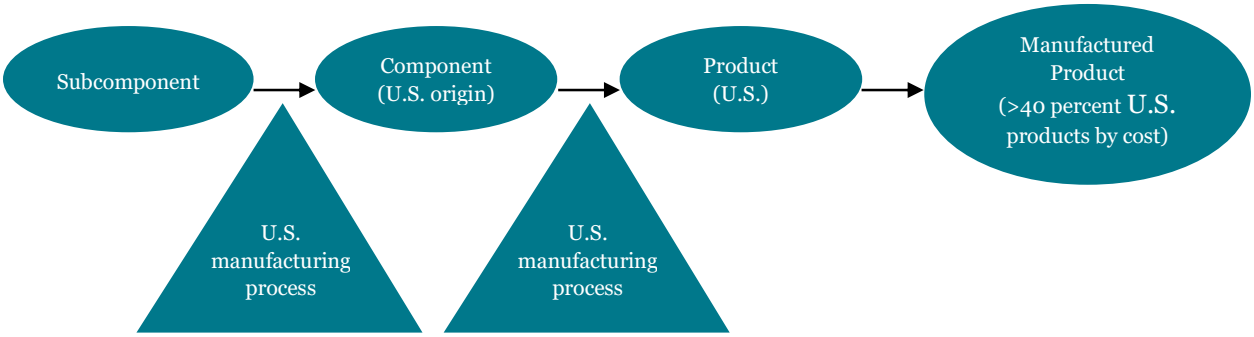
II. Bonus Credit Availability

The domestic content bonus credits are available for both the Code Section 45 PTC and the Code Section 48 ITC. The bonus credits will also apply to the Code Section 45Y tech-neutral PTC and Code Section 48E tech-neutral ITC when those credits become available for projects beginning construction in 2025 or later.

There are two tests to satisfy to claim the domestic content bonus credit:

- All "steel and iron components" (as defined below) must be produced in the U.S.
- 40 percent of the total costs of all components that are "manufactured products" (as defined below) (including components) must be mined, produced, or manufactured in the U.S. (20 percent for offshore wind facilities). These percentages are scheduled to increase for projects beginning construction after 2024.

The diagram below shows the basic operation of the 40 percent test for manufactured products.



In general, the domestic content rules are complex as there are several different categories and layers of components and subcomponents. At the highest level are three separate types of components that must be domestically sourced under the statute: iron components, steel components, and components that are manufactured products. The rules for steel and iron components are different than those for components that are manufactured products. Manufactured products must be further analyzed to identify their component parts. These manufactured product components can themselves have subcomponents that are exempt from the domestic sourcing requirements.

III. Domestic Content Requirements

An applicable project satisfies the domestic content requirement if both the "Steel or Iron Requirement" and the "Manufactured Products Requirement" are satisfied. One hundred percent of iron and steel, and at least 40 percent (increasing to 55 percent over time) of the cost of manufactured products must be produced in the United States, except for offshore wind facilities, for which at least 20 percent (increasing to 55 percent over time) must be produced in the United States. All project components will be categorized as either construction materials that are structural in function (to which the Steel or Iron Requirement applies) or manufactured products (to which the Manufactured Products Requirement applies).

IRS Notice 2023-38 (released May 12, 2023) (the "Notice") provides a nonexhaustive categorization of applicable project components for both categories for utility-scale solar, land-based wind, offshore wind, and battery storage technology. However, the Notice does not provide any categorizations for assets used in distributed generation projects. The categorizations provided in the Notice are as follows:

- Utility-Scale Photovoltaic System
  - Steel or Iron Requirement: steel module racking, pile or ground screw, and rebar in foundation (e.g., concrete pad)
  - Manufactured Products Requirement: Photovoltaic trackers, modules (which includes other Manufactured Product Components, if applicable, including a

photovoltaic cell, mounting frame or backrail, glass, encapsulant, backsheet, junction box (including pigtails and connectors), edge seals, pottants, adhesives, bus ribbons, and bypass diodes), and inverters

- Land-Based Wind
  - Steel or Iron Requirement: Tower, steel or iron rebar in foundation (e.g., spread footing)
  - Manufactured Products Requirement: Wind turbine (which includes the following Manufactured Components, if applicable: nacelle, blades, rotor hub, and power converter), wind tower flanges
- Offshore Wind
  - Steel or Iron Requirement: Tower, jacket foundation
  - Manufactured Products Requirement: Wind tower flanges, wind turbine (which includes the following Manufactured Product Components, if applicable: nacelle, blades, rotor hub, and power converter), transition piece, monopile, inter-array cable, offshore substation, export cable
- Battery Storage Technology
  - Steel or Iron Requirement: Steel or iron rebar in foundation (e.g., concrete pad)
  - Manufactured Products Requirement: Battery pack (which includes the following Manufactured Components, if applicable: cells, packaging, thermal management system, and battery management system), battery container/housing, inverter

Steel or Iron Requirement

The Steel or Iron Requirement applies to applicable project components that are construction materials made primarily of steel or iron and are structural in function. The Steel or Iron Requirement does not apply to steel or iron used in manufactured product components or subcomponents of manufactured product components (e.g., nuts, bolts, screws, washers, and other small subcomponents that are made primarily of steel or iron but are not structural in function). The Steel or Iron Requirement is met if all manufacturing processes with respect to any steel or iron items that are applicable project components take place in the United States, except metallurgical processes involving refinement of steel additives.

Manufactured Products Requirement

The Manufactured Products Requirement is met if all manufactured products that are components of an applicable project are produced or deemed to be produced in the United States, inclusive of U.S. possessions. A Manufactured Product means an item that is produced as a result of a manufacturing process, and is treated as produced in the United States if all the manufacturing processes for the Manufactured Product take place in the United States and all of

the components of the Manufactured Product are of U.S. origin (a "U.S. manufactured product"). A Manufactured Product Component means any article, material, or supply, whether manufactured or unmanufactured, that is directly incorporated into an applicable project component that is itself a Manufactured Product, and considered to be of U.S. origin if it is manufactured in the United States, regardless of the origin of its subcomponents (a "U.S. Manufactured Product Component"). Essentially, this means that there can be "Manufactured Product Components" that are themselves not manufactured, but that are incorporated into a project component that is considered a "Manufactured Product."

All manufactured products that are components of an applicable project are deemed to be produced in the United States if the "domestic cost percentage," which is the percentage produced by dividing the costs incurred to manufacture Manufactured Products in the United States and to mine, produce, or manufacture components of non-U.S. Manufactured Products in the United States by the total costs incurred to produce each Manufactured Product, equals or exceeds the "adjusted percentage" that applies to the applicable project.

The adjusted percentages of domestic content for manufactured products are as follows:

- 40 percent for projects that begin construction prior to 1/1/25;
- 45 percent for projects that begin construction after 12/31/24, but before 1/1/26;
- 50 percent for projects that begin construction after 12/31/25, but before 1/1/27; and
- 55 percent for projects that begin construction after 12/31/26

Offshore wind projects have their own adjusted percentage requirements:

- 20 percent for projects that begin construction prior to 1/1/25;
- 27.5 percent for projects that begin construction after 12/31/24, but before 1/1/26;
- 35 percent for projects that begin construction after 12/31/25, but before 1/1/27;
- 45 percent for projects that begin construction after 12/31/26, but before 1/1/28; and
- 55 percent for projects that begin construction after 12/31/27

The cost of a Manufactured Product includes only direct costs (as defined in Treasury Regulations Section 1.263A-1(e)(2)(i), i.e., direct material and direct labor costs) that are paid or incurred (within the meaning of Code Section 461) by the manufacturer of the Manufactured Product to produce the Manufactured Product. The cost of a U.S. Manufactured Product Component of a non-U.S. Manufactured Product includes only direct costs (as defined in Treasury Regulations Section 1.263A-1(e)(2)(i), i.e., direct material and direct labor costs) that are paid or incurred (within the meaning of Code Section 461) by the manufacturer of the non-U.S. Manufactured Product to produce or acquire the U.S. Manufactured Product Component.

Direct costs (including direct labor costs) of incorporating the applicable project components into the applicable project are not counted.

Crucially, project owners must determine whether components are considered direct components of a manufactured product or are subcomponents of another component of the manufactured product because the sourcing of subcomponents will not affect the adjusted percentage calculation. The Notice provides little guidance on how to group or divide components or subcomponents apart from the general definition of a component.

The manufactured products fraction will compel project developers to request detailed cost segregation information from manufacturers with respect to products delivered to a project site for incorporation into a project. To determine the amount of domestic manufactured products and components costs, developers will need to obtain direct cost information (i.e., direct materials and direct labor costs that are paid or incurred by the manufacturer). This information includes both U.S. and non-U.S. source labor costs, with both costs being included in the denominator and the U.S.-source costs being included in the numerator of the manufactured products fraction. However, indirect costs, such as rent, overhead, and utilities are not to be included in the calculation.

The diagrams below are examples of how to accurately track direct material and labor costs of project components to ensure the project meets both the Steel or Iron Requirement and the Manufactured Products Requirement, respectively.

Steel or Iron Project Component	Origin of Manufacturing (not source of iron ore or steel additives)
Steel Module Racking	[Country]
Pile or Ground Screw	[Country]
Rebar in Foundation (e.g., concrete pad)	[Country]

Manufactured Product	Manufactured Product Component	Origin	Material / Labor Cost
PV Trackers	N/A	[Country]	( )

Manufactured Product	Manufactured Product Component	Origin	Material / Labor Cost
Modules	PV Cell	[Country]	( )
	Mounting Frame	[Country]	( )
	Backsheet	[Country]	( )
	Junction Box	[Country]	( )
Inverters	N/A	[Country]	( )
Total Direct Costs of US Manufactured Products and Manufactured Product Components			**[ ]**
Total Adjusted Percentage of Domestic Costs			**[ ]**

Finally, the Notice may compel manufacturers to ask for premiums on materials for which the manufacturer can certify would qualify for the domestic content bonus and provide supporting documentation.

IV. Retrofitted Facilities

The Notice provides specific rules regarding the domestic content requirement in respect of retrofitted projects. A retrofitted project is eligible for the domestic content bonus credit if i) it is placed in service after December 31, 2022, ii) the fair market value of the used property is not more than 20 percent of the project's total value calculated by adding the cost of the new property to the value of the used property, and iii) the new property meets the domestic content

requirement and the taxpayer complies with the certification and recordkeeping requirements discussed below.

V. Safe Harbor for Classification of Certain Applicable Project Components

The Notice identifies certain project components commonly found in utility-scale photovoltaic systems, land-based wind facilities, offshore wind facilities and battery energy storage technologies, and categorizes such applicable project components as subject to either the Steel or Iron Requirement or the Manufactured Products Requirement. The Notice clarifies that the identified items may not be an exhaustive set of applicable project components for those types of applicable projects and that these identified applicable projects and applicable project components must meet the statutory requirements to be eligible for the relevant PTC and ITC and the domestic content bonus credit. In the absence of further guidance, project owners must make a determination on a component-by-component basis if a component is not listed in the Notice.

VI. Certification Requirements

The Notice provides that a taxpayer must submit to the IRS a statement certifying for each applicable project for which a taxpayer is reporting a domestic content bonus credit amount. The taxpayer must certify that the applicable project meets the domestic content requirement as of the date the applicable project is placed in service (i.e., the date on which such property is placed in a condition or state of readiness and availability for a specifically assigned function, whether in a trade or business or in the production of income).

In particular, the statement must include the following information: i) whether the applicable project is a qualified facility, energy project, or energy storage technology; ii) the specific type of applicable project; iii) the geographic coordinates and the address (if applicable) of the applicable project; iv) the date the applicable project was placed in service; v) the total domestic content bonus credit amount with respect to the applicable project in the first taxable year in which the taxpayer reports a domestic content bonus credit amount for such applicable project; and vi) any additional information with respect to the applicable project that is required by the applicable forms and instructions for reporting domestic content bonus credit amounts. The statement must be signed by a person with legal authority to bind the taxpayer and contain the following statement: "Under penalties of perjury I declare that I have examined the information contained in this Domestic Content Certification Statement and to the best of my knowledge and belief, it is true, correct, and complete."

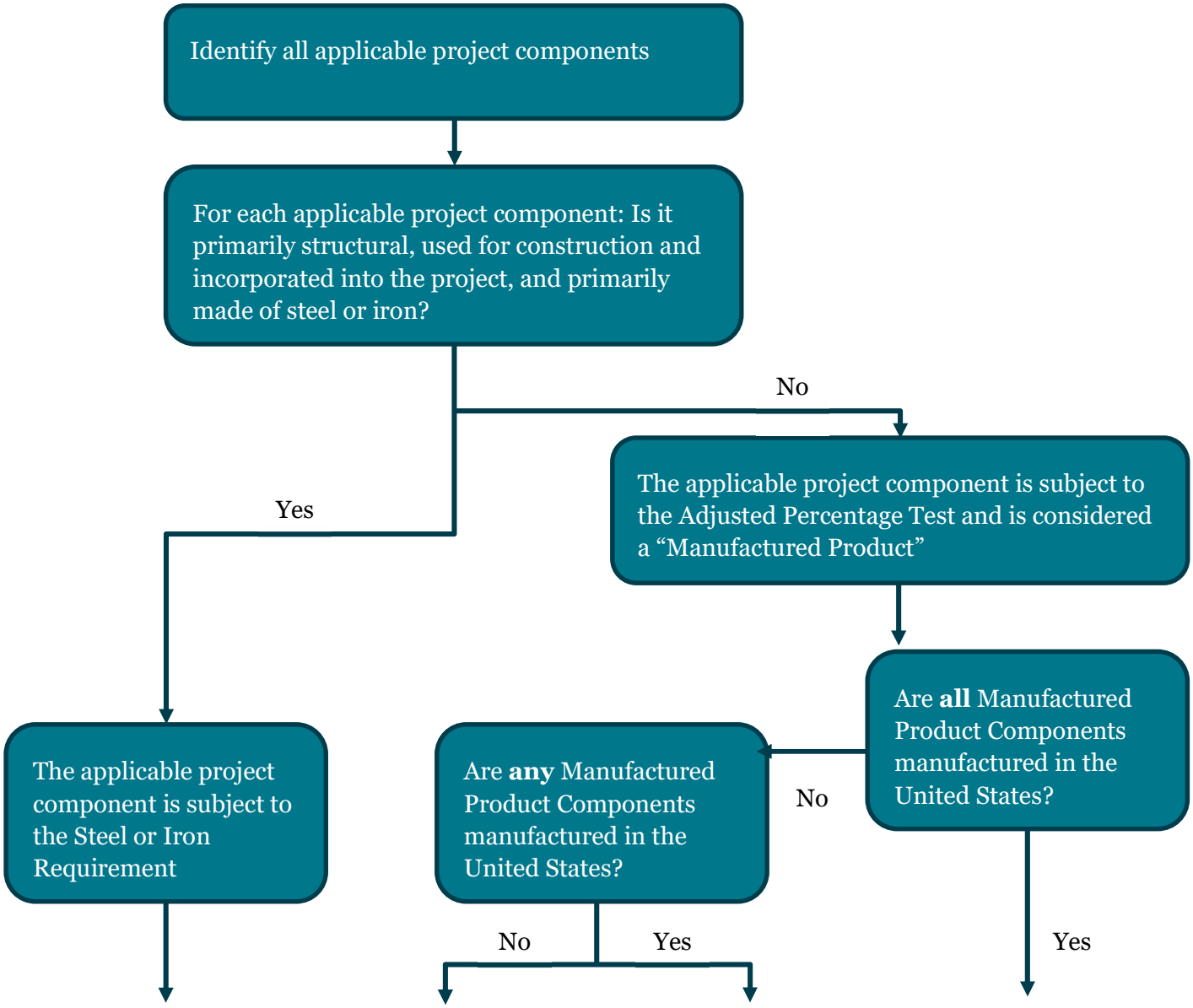
The taxpayer must attach the statement to Form 8835 (Renewable Electricity Product Credit), Form 3468 (Investment Credit), or other applicable form for the first taxable year in which the taxpayer reports a domestic content bonus credit amount for such applicable project. If the taxpayer reports a domestic content bonus credit amount for a PTC project, the taxpayer must in each subsequent taxable year attach to its annual return a copy of the statement filed in the first taxable year.

As of the date of this white paper, the IRS has declined to provide any additional specific record-keeping requirements to substantiate bonus credits, instead providing only that the general record-keeping requirements under Code Section 6001 apply. Under Code Section 6001 and Treasury Regulations promulgated thereunder, the taxpayer must keep permanent books of account or records that are sufficient to establish the domestic content bonus credit amount and retain such books and records so long as the project is potentially subject to a tax assessment.

VII. Example

To illustrate a basic example of a project's qualification for the domestic content bonus credit, assume a project sponsor is developing a solar photovoltaic system. The sponsor will hire an engineer to build the project, construction on which will begin in late 2023. The project materials consist of inverters, trackers, modules, steel beams, and a transformer. The steel beams are considered to be construction materials that are subject to the Steel or Iron Requirement, meaning that 100 percent of the steel beams must be manufactured in the United States. The other components are manufactured products subject to the Manufactured Products Requirement. Assume that the project sponsor purchases the modules and inverters directly from the manufacturers and provides them to the contractor. The modules and inverters are both manufactured outside the United States. Thus, the direct manufacturing costs would go into the denominator of the Manufactured Products Requirement fraction. The trackers and transformer are made entirely in the United States. Some of the components of the trackers are imported, but otherwise all components of the trackers and transformer are made in the United States. The direct manufacturing costs to make the trackers and transformer would go into the denominator of the fraction. All of the direct manufacturing costs for the transformer would also go into the numerator of the fraction, and the direct manufacturing costs for the U.S.-made components of the trackers would go into the numerator. Labor costs incurred at the project development site would not be included in the fraction. Provided the fraction yields at least 40 percent U.S.-made components, the Manufactured Products Requirement would be met.

A simplified diagram of this calculation follows.



One-hundred percent of steel or iron must be manufactured in the United States (other than metallurgical processes involving refinement of steel additives), but the origin of the iron ore or additives does not matter.

None of the direct costs for the applicable project component qualify as domestic.

Product is a **"non-U.S. manufactured product"** Therefore, direct labor and materials costs of non-US manufactured products or components **do not qualify** as domestic.

Only costs to produce or acquire US-made manufactured products components **qualify** as domestic.

The project component qualifies as **"U.S. manufactured product."**

All direct labor and materials costs of manufacturers of its manufactured product and manufactured product components **qualify as domestic.**

VIII. Conclusion

The domestic content bonus credit could provide a substantial benefit but could also increase the costs of projects. Project owners must model the potential impact of sourcing the required components domestically. Importantly, project owners seeking to claim a domestic content bonus credit may need to obtain significant information from suppliers and contractors, and should consider adding sourcing requirements and substantiation procedures into contracts. Finally, project owners who begin construction on projects in the next few months can choose between applying the methodology set forth in the Notice for purposes of determining whether such project meets the Steel or Iron Requirement and the Manufactured Products Requirement, or alternatively using whatever methodology is ultimately adopted in proposed regulations expected to be released in late 2023.