

## Treasury and IRS Release Proposed Regulations on Consumer Electric Vehicle Tax Credits

April 10, 2023

On March 31, the Treasury Department and the Internal Revenue Service (IRS) released proposed regulations under Section 30D of the Internal Revenue Code (Code),<sup>1</sup> focusing primarily on the critical mineral and battery component requirements to qualify for the consumer electric vehicle (EV) tax credit under Section 30D. These proposed regulations are specific to the Section 30D EV tax credit and do not include regulations under Section 45W for the commercial EV tax credit for EVs used or leased as depreciable assets in a trade or business.

The proposed regulations include a range of definitions and substantive provisions describing the critical minerals and battery components requirements for the Section 30D EV tax credit. The 2022 Inflation Reduction Act provided that the critical minerals and battery components requirements under Section 30D(e) would not apply for purposes of determining the amount or availability of the Section 30D EV tax credit until such time as proposed regulations were issued. The proposed regulations state that the critical minerals and battery components requirements under Section 30D, as described in the proposed regulations, will apply to EVs placed in service after April 17, 2023. The balance of the proposed regulations under Section 30D will apply to EVs placed in service after the date that final regulations are published in the *Federal Register*, except that a taxpayer may rely on such proposed regulations starting January 1, 2023 for EVs placed in service after 2022 and prior to that publishing date if the taxpayer follows the proposed regulations in their entirety and in a consistent manner.

Section 30D provides for a US federal income tax credit of up to \$7,500 for each qualifying new EV placed in service by a taxpayer. That \$7,500 tax credit amount is the sum of two separate amounts: \$3,750 for each new EV that satisfies the critical minerals requirements and \$3,750 for each new EV that satisfies the battery components requirements. If an EV satisfies only the critical minerals requirements or only the battery components requirements, the Section 30D EV tax credit will be limited to \$3,750. If an EV does not satisfy either the critical minerals or battery components requirements, then the Section 30D EV tax credit will not be available.

### Critical Minerals Requirements for EV Batteries

The critical minerals requirements of Section 30D look to the percentage of the value of the applicable critical minerals contained in an EV battery that were extracted or processed in the United States or in a country with which the United States has a free trade agreement (FTA) in effect (an FTA country), or that were recycled in North America. For EVs placed in service after April 17, 2023 through the end of the year, the applicable percentage of value requirement for such critical minerals is 40 percent. The applicable percentage increases each calendar year by 10 percent until it reaches 80 percent for EVs placed in service after 2026. For EVs placed in service in 2023 but prior to April 18, 2023, the critical minerals requirements of Section 30D do not apply for purposes of determining the amount or availability of the EV tax credit.

<sup>1</sup> Section references in this discussion are to the Internal Revenue Code of 1986, as amended, or to the Treasury Department regulations promulgated or proposed thereunder, unless otherwise specified.

The list of approximately fifty different minerals that are “applicable critical minerals” for purposes of Section 30D can be found in Section 45X (which otherwise provides for the advanced manufacturing production credit). Those critical minerals include, for example, cobalt, lithium, manganese, nickel and tungsten.

The proposed regulations create a three-step process for determining the percentage of the value of the applicable critical minerals in an EV battery that are qualifying critical minerals, and therefore contribute towards satisfying the Section 30D(e) critical minerals requirement:

**Step One:** The manufacturer determines the procurement chain for each applicable critical mineral. A procurement chain is the common sequence of extraction, processing or recycling activities that occur in a common set of locations and that conclude in the production of constituent materials. Constituent materials are those materials that contain applicable critical minerals and are employed directly in the manufacturing of battery components. Sources of a single applicable critical mineral may have multiple procurement chains.

**Step Two:** Each applicable critical mineral procurement chain in the battery is evaluated to determine whether critical minerals procured from the chain have been extracted or processed in the United States or in an FTA country, or recycled in North America. An applicable critical mineral would be treated as extracted or processed in the United States or in an FTA country if 50 percent or more of the value added to the applicable critical mineral by extraction or processing is derived from extraction or processing that occurred in the United States or in an FTA country. An applicable critical mineral is treated as recycled in North America if 50 percent or more of the value added to the applicable critical mineral by recycling is derived from recycling that occurred in North America. Applicable critical minerals meeting the 50 percent value added threshold are “qualifying critical minerals”.

The 50 percent value added threshold was selected due to the complexity of battery supply chains and the detailed tracking required to determine the value of all critical minerals in a battery. According to the Treasury Department and the IRS, the 50 percent value added threshold to be treated as qualifying critical minerals likely will become more stringent after 2024. The Treasury Department and the IRS are requesting comments on the 50 percent value added threshold and the best approach for adopting a more stringent test.

Section 30D does not include a definition of “free trade agreement.” Instead, the Treasury Department and the IRS stated that they will identify countries with which the United States has a free trade agreement for Section 30D purposes based on whether there is an agreement that reduces or eliminates trade barriers on a preferential basis, commits the parties to refrain from imposing new trade barriers, establishes high-standard disciplines in key areas affecting trade (such as core labor and environmental protections), and/or reduces or eliminates the restrictions on exports or commits the parties to refrain from imposing such restrictions. Based on those factors, the Treasury Department and the IRS have determined that the countries with which the United States currently has a free trade agreement in effect are: Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, South Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, and Singapore. The Treasury Department and the IRS are considering adding additional countries, including Japan.

**Step Three:** The “qualifying critical mineral content” of a battery is determined by dividing the total value of qualifying critical minerals by the total value of the applicable critical minerals in the battery. The date for making this determination is a date selected by the manufacturer, so long as such date occurs after the final processing or recycling of the applicable critical minerals and the date is uniformly applied for all applicable critical minerals in a battery. A manufacturer may determine qualifying critical minerals content based on the value of the applicable critical minerals actually contained in the battery of a specific EV, or

may do so for a group of EVs by averaging the qualifying critical minerals content calculation over a limited period of time (e.g., a year, quarter or month) with respect to EVs from the same model line, plant, class or some combination thereof. The percentage of qualifying critical minerals content calculated in step three is compared with the relevant applicable minerals percentage value requirement (e.g., 40 percent after April 17, 2023 and through the end of 2023) for purposes of determining if the EV is eligible for the \$3,750 critical minerals portion of the EV tax credit.

## Battery Components Requirements for EV Batteries

The battery components requirements of Section 30D look to the percentage of the value of the components contained in an EV battery that were manufactured or assembled in North America. For EVs placed in service after April 17, 2023, the applicable percentage for such battery components is 50 percent. The applicable percentage increases each year by 10 percent until it reaches 100 percent for EVs placed in service after 2028. For EVs placed in service in 2023 but prior to April 18, 2023, the battery components requirements of Section 30D do not apply for purposes of determining the amount or availability of the EV tax credit.

A battery component is a component that forms part of a battery and that is manufactured or assembled from one or more components or constituent materials that are combined through industrial, chemical, and physical assembly steps. Battery components may include, but are not limited to, a cathode electrode, anode electrode, solid metal electrode, separator, liquid electrolyte, solid state electrolyte, battery cell, or battery module.

The proposed regulations create a four-step process for determining the percentage of the value of the components contained in an EV battery that are “North American battery components” and therefore contribute toward satisfying the Section 30D(e) battery components requirement:

**Step One:** A manufacturer determines whether each battery component was manufactured or assembled in North America. If substantially all of the manufacturing or assembly activities of a battery component occur in North America, then that component is a “North American battery component” regardless of the location of the manufacturing or assembly activity of the components that make up that battery component.

**Step Two:** A manufacturer determines the “incremental value” for each battery component, including each North American battery component. The “incremental value” of each battery component is the value determined by subtracting from the value of the battery component the value of the manufactured or assembled battery components, if any, that are contained in the battery component.

**Step Three:** A manufacturer determines the total incremental value of all battery components.

**Step Four:** The “qualifying battery component content” of a battery is determined by dividing the total incremental value of North American battery components by the total incremental value of all battery components. The date for making this determination is a date selected by the manufacturer, so long as such date occurs after the last manufacturing or assembly step for the battery components relevant to the Section 30D EV battery certification and the date is uniformly applied for all battery components in a battery. A manufacturer may determine qualifying battery component content based on the value of the applicable battery components actually contained in the battery of a specific EV, or may do so for a group of EVs by averaging the qualifying battery component content calculation over a limited period of time (e.g., a year, quarter or month) with respect to EVs from the same model line, plant, class or some combination thereof. The percentage of qualifying battery component content calculated in step four is compared with the relevant applicable battery component percentage value requirement (e.g., 50 percent after April 17, 2023 and through the end of 2023) for purposes of determining if the EV is eligible for the \$3,750 battery components portion of the EV tax credit.

## Additional Relevant Matters

**Qualified Manufacturer Requirement.** The manufacturer making the critical minerals and battery components determinations described above must be a “qualified manufacturer” for purposes of Section 30D. The proposed regulations define a qualified manufacturer for that purpose as any manufacturer (as determined under 42 U.S.C. 7521 et seq.) that enters into a written agreement with the Treasury Department under which such manufacturer agrees to make periodic written reports to the Treasury Department providing information related to each EV manufactured by such manufacturer as required by the Treasury Department.

**Excluded Entities (Foreign Entities of Concern).** Section 30D(d)(7) provides that an EV will not be entitled to the EV tax credit under Section 30D if the EV is placed in service (x) after 2024 and any applicable critical minerals contained in the battery of the EV were extracted, processed, or recycled by a foreign entity of concern (as defined in section 40207(a)(5) of the Infrastructure Investment and Jobs Act, 42 U.S.C. section 18741(a)(5)), or (y) after 2023 and any battery components of the EV were manufactured or assembled by such a foreign entity of concern. The proposed regulations do not include rules regarding foreign entities of concern. The proposed regulations state that rules addressing such entities will be included in the final regulations.

**Final Assembly Requirement.** Any EV sold after August 16, 2022 must have its “final assembly” in North America to be eligible for the Section 30D EV tax credit. The proposed regulations define “final assembly” as the process by which a manufacturer produces a new EV at, or through the use of, a plant, factory or other place from which the EV is delivered to a dealer or importer with all component parts included with the EV that are necessary for the mechanical operation of the EV, whether or not the component parts are permanently installed in or on the EV. The location of final assembly for a new EV for purposes of determining qualification for the Section 30D EV tax credit is the final assembly point reported on the label affixed to the EV.

**MSRP Limitation.** The Section 30D EV tax credit provides limitations on the “manufacturer’s suggested retail price,” or MSRP, to qualify for the credit. For a van, SUV or pick-up truck, the MSRP limit is \$80,000. For all other vehicles, the MSRP limit is \$55,000. The proposed regulations maintain the definitions of van, SUV and pick-up truck that were announced in IRS Notice 2023-16, which are based on definitions provided in regulations issued by the Environmental Protection Agency.

**Modified AGI Limitation.** The Section 30D EV tax credit is not allowed if the lesser of the EV owner’s modified adjusted gross income (AGI) for the taxable year in which the EV is placed in service and the EV owner’s modified AGI for the taxable year prior to the year in which the EV is placed in service exceeds \$300,000 in the case of a joint return or a surviving spouse, \$225,000 in the case of a head of household, and \$150,000 for all other individual taxpayers. The proposed regulations provide that in the case of an EV owned by a corporation or another taxpayer that is not an individual, a partnership or S corporation, the modified AGI limitation does not apply. For an EV owned by a partnership or S corporation, the modified AGI limitation applies to the partners or shareholders (see the discussion below regarding an EV owned through a passthrough entity).

**Multiple Owners of EVs and Passthrough Entity Ownership of EVs.** If multiple owners purchase an EV, only one taxpayer may claim the Section 30D EV tax credit per EV, even though all such owners may otherwise be qualified to take the Section 30D EV tax credit. This could happen, for example, if a married couple that files separate tax returns purchases an EV. The proposed regulations provide that in the case of multiple owners, such owners will inform the seller as to which owner will claim Section 30D EV tax credit and the Section 30D EV tax credit will be allowed only on the tax return of the owner listed on the seller’s report.

In the case of an EV placed in service by a partnership or S corporation, the proposed regulations provide that the Section 30D EV tax credit is to be allocated among the partners of the partnership under Treasury regulations section 1.704-4(b)(4)(ii) or among the shareholders of the S corporation under Sections 1366(a) and 1377(a), and is to be claimed on the tax returns of such partners or shareholders. The name and tax identification number

of such partnership or S corporation is to be listed on the seller's report to the IRS, along with the vehicle identification number of the EV.

**No Double Benefit.** The Section 30D EV tax credit is allowed only once per EV. Also, the proposed regulations state that if the Section 30D EV tax credit is claimed, the Section 45W EV tax credit cannot also be claimed.

**EV Tax Credit Recapture.** Section 30D(f)(5) provides that the Treasury Department and IRS will issue regulations providing for recapturing the benefit of any Section 30D EV tax credit allowable with respect to any EV which ceases to be eligible for such credit. The proposed regulations do not cover recapture of the Section 30D EV tax credit. Although the Treasury Department and the IRS asked the public for comments on recapture, the proposed regulations do not include rules on recapture and do not include a statement as to when such rules would be issued.

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