

The Section 45X Advanced Manufacturing Production Tax Credit Should Cover Direct and Indirect Materials Costs and Costs Related to Extraction

Issue

In December 2023, the Department of the Treasury and the IRS proposed guidance to implement the Section 45X Advanced Manufacturing Production Tax Credit.¹ However, **the proposed guidance excludes direct and indirect material costs and costs related to the extraction of raw materials.**² This proposed exclusion was intended to “mitigate the risk of crediting the same cost multiple times” and to ensure that the credit is provided for production activities that add value to the applicable critical mineral. In practice, however, the exclusion could curtail and constrain the intended benefits of the Section 30D New Clean Vehicle Tax Credit.

Implications

The clean vehicle incentives in the IRA have two key policy objectives: increase EV deployment to counter Foreign Entity of Concern (FEOC) influence by “friendshoring” clean energy supply chains. Designed to complement each other, the Section 30D New Clean Vehicle Tax Credit and the Section 45X Advanced Manufacturing Production Tax Credit will be the main drivers of these policy outcomes.

As proposed, the recent 45X credit guidance will help achieve neither and could hinder the success of both provisions. Without a robust, secure supply of critical minerals and battery components, increasingly stringent sourcing requirements tied to 30D eligibility could make fewer vehicles eligible over time. The decision to restrict access to the 45X credit for direct and indirect materials costs will curtail future critical minerals supply, worsening a pre-existing bottleneck³ rather than alleviating it.

This will have the practical effect of capping the 30D credit’s ability to increase EV deployment and build a domestic critical mineral, battery component, and battery recycling supply chain. Failing to count direct and indirect material costs and costs related to the extraction of raw materials as eligible to receive the 45X credit in tandem with the IRA’s 30D eligibility criteria could, in effect, phase the 30D credit out faster than the IRA’s statutory expiration in 2032.

Solution

As Treasury explains in the proposed regulations, three conditions must be met for the inclusion of direct and indirect material costs and extraction costs under 45X: (1) IRS must be able to “effectively administer” the inclusion of direct and indirect material costs and extraction costs; (2) the inclusions must pose a limited risk of crediting the same production cost multiple times; and (3) the inclusion must pose a limited risk of increasing other forms of fraud, waste, and abuse. **These three conditions can be satisfied for direct and indirect material costs and extraction costs by relying on general tax law principles, application of the proposed section 45X anti-abuse rule, and adopting certification and documentation requirements from existing tax provisions.**

¹ See 88 FR 86844 (Dec. 15, 2023)

² As defined in proposed § 1.263A-1(e)(2)(i)(A) and § 1.263A-1(e)(3)(ii)(E) respectively.

³ <https://www.zeta2030.org/insights/critical-mineral-permitting-reform-framework>

Background

Critical minerals are essential globally for commodities such as electric vehicles (EVs), modern electronics, healthcare technology, and national security infrastructure. S&P Global estimates that due to the Inflation Reduction Act (IRA), the U.S. projected demand for lithium will increase 15% by 2035 from estimates before the legislation (nickel, 14%; cobalt, 13%; and copper, 12%).⁴ A key provision in the IRA is the Section 45X Advanced Manufacturing Production Tax Credit, which incentivizes private entities to develop a robust, domestic supply of critical minerals and battery components.

If implemented strategically, the 45X credit will usher in a new era of American industrial expansion over the next decade that facilitates the widespread deployment of domestically-produced, affordable clean energy technologies—particularly electric vehicles. The credit provides \$35 per kWh for each battery cell and \$10 per kWh for each battery module. It also covers 10% of the costs of production of applicable critical materials, which will significantly drive down the costs of domestic clean energy manufacturing.

The IRA also modified the Section 30D New Clean Vehicle Tax Credit. Provided the vehicle purchaser and manufacturer meet the necessary qualifications, the revision reduces the cost of new EVs by \$7,500. Qualified manufacturers must meet increasingly stringent content requirements that require sourcing battery components from North America and critical minerals from free trade agreement (FTA) countries. Because both requirements must be met for an EV to be eligible for the 30D credit, significant new investment is necessary to scale critical mineral production, EV battery manufacturing, and recycling either domestically or in FTA countries and maximize the impact of the 30D credit. Thoughtful implementation of the 45X credit would intentionally recognize its nexus as an essential tool to meet 30D domestic content sourcing requirements. Strategic 45X credit implementation is therefore central to the success of broader U.S. industrial strategy.

⁴ <https://www.spglobal.com/marketintelligence/en/mi/research-analysis/us-ira-and-critical-mineral-supply-challenge.html>