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WHITE PAPER

August 2022

The Inflation Reduction Act: Impact on Electric Vehicle and Transportation Industries

The Inflation Reduction Act of 2022 (the "Act"), signed into law by President Biden this month, offers new or expanded tax incentives for buying electric vehicles ("EVs") and using or producing certain environmentally friendly fuels. This *White Paper* summarizes these tax incentives, as relevant to the EV industry and the transportation industry more generally.

The Act expands the existing tax credits under the Internal Revenue Code (the "IRC") for new EV purchases and creates two new EV tax credits, one for purchases of previously owned EVs and the other for purchases of EV for business use. These EV tax credits are poised to stimulate demand for EV technology. Individual consumers may claim up to $7,500 in credits for purchasing new EVs, so long as the EVs are assembled in North America and meet the legislation's requirements for sourcing certain "critical minerals" from the United States (or certain other countries) and for manufacturing battery components in North America. Individual consumers may also claim up to $4,000 in credits for purchasing used EVs. Business taxpayers may earn a credit for purchasing EVs for use in a trade or business, including up to $40,000 for heavy-duty EVs. The Act also makes credits available for installing charging stations and other qualifying refueling equipment.

Further, the Act renews several alternative fuel credits and institutes a one-time retroactive claim for the alternative fuel and alternative fuel mixture credits, which expired last year. The Act reinstates the tax credit for producing second generation biofuel and creates a new tax credit for producing sustainable aviation fuel. Taxpayers also may now claim a new clean hydrogen tax credit of $3.00 per kilogram of clean hydrogen produced, subject to several requirements (including that a facility that claims carbon capture credits may not claim clean hydrogen credits).

The below chart summarizes the key EV tax credits and transportation-related incentives available to taxpayers under the Act.

SUMMARY OF ELECTRIC VEHICLE TAX CREDIT PROVISIONS MODIFICATION OF CLEAN VEHICLE CREDIT FOR PURCHASES OF NEW VEHICLES

(IRC § 30D)

(IRA § 13401)

Effective Date Effective for vehicles placed in service after December 31, 2022 and before January 1, 2033.

Current Law Buyers of qualifying plug-in EVs may claim a nonrefundable tax credit of up to $7,500. The credit begins to phase out once a vehicle manufacturer has sold 200,000 qualifying vehicles, which several manufacturers have met.

Change The new credit for clean vehicles is $3,750 for vehicles meeting the "critical minerals" requirements and $3,750 for vehicles meeting the "battery components" requirements (i.e., up to $7,500 total). To receive the critical minerals portion of the credit, the vehicle's battery must contain a threshold percentage (that increases over time) of critical minerals that were extracted or processed in the United States or a country with which the United States has a free trade agreement or that were recycled in North America. To receive the battery components portion of the credit, the percentage of the battery's components manufactured or assembled in North America must meet a threshold percentage (which increases over time).

The credit will no longer phase out based on the number of qualifying vehicles that the dealer has sold.

The credit is disallowed for certain higher-income taxpayers (modified AGI of over $300,000 for married and $150,000 for single taxpayers) and does not apply for vehicles with an MSRP greater than $80,000 for SUVs, vans, and pickup trucks and $55,000 for other vehicles.

Starting in 2024, taxpayers may elect to transfer the credit to dealers that meet certain requirements. Such a transfer may allow for the buyer to negotiate for a lower price in exchange for the credit.

Insights This credit could increase the demand for EVs with batteries and other key components produced in the United States. However, the general availability of critical minerals is already limited, and the strict sourcing requirements may make it difficult (or impossible) to take advantage of the credit in the short term while manufacturers adjust. Commentators have noted that no vehicle manufacturers currently meet the bill's requirements.

A transition rule requires that no credit may be claimed after the enactment of the IRA unless final assembly of the vehicle is in North America.

Revenue Estimate: ($7.5 billion)

NEW PREVIOUSLY-OWNED CLEAN VEHICLE CREDIT

(IRC § 25E)

(IRA § 13402)

Effective Date Effective for vehicles acquired after December 31, 2022 and before January 1, 2033.

Current Law There is no current credit for the purchase of used plug-in electric or fuel cell vehicles.

Change This provision creates a new tax credit up to $4,000 (capped at 30% of the purchase price) for individual buyers of used qualified plug-in electric and fuel cell vehicles.

The credit is limited to vehicles sold by a dealer and on the first transfer of a qualifying vehicle, and to vehicles purchased for $25,000 or less and for which the model year is at least two years prior to the calendar year of the sale. A taxpayer may not claim the credit if the taxpayer has previously claimed this credit during the 3-year period before the date of the sale.

The credit is disallowed for certain higher-income taxpayers (modified AGI of over $150,000 for married and $75,000 for single taxpayers).

Starting in 2024, taxpayers may elect to transfer the credit to dealers that meet certain requirements.

Insights Unlike the clean vehicle credit for purchases of new EVs, there is no battery or minerals requirement or North America assembly requirement.

Revenue Estimate: ($1.3 billion)

NEW QUALIFIED COMMERCIAL CLEAN VEHICLE CREDIT

(IRC § 45W)

(IRA § 13403)

Effective Date Effective for vehicles acquired after December 31, 2022 and before January 1, 2033.

Current Law As described above, buyers of qualifying plug-in EVs may claim a nonrefundable tax credit of up to $7,500. The credit phases out once a vehicle manufacturer has sold 200,000 qualifying vehicles.

Change This provision creates a new credit for each qualified commercial clean vehicle purchased for use by a taxpayer. Generally, the vehicle must be used in the trade or business or held for the production of income.

The amount of the credit is the lesser of (i) 15% of the vehicle's tax basis (or 30% for non-gasoline/diesel vehicles), or (ii) the excess of the purchase price of the vehicle over that of a gasoline/diesel-powered vehicle of comparable size and use. The credit is capped at $7,500 for vehicles weighing less than 14,000 pounds and $40,000 for heavier vehicles. Mobile machinery and qualified commercial fuel cell vehicles are also eligible for this credit.

A taxpayer cannot receive both this credit and the general clean vehicle credit described above with respect to the same vehicle, so where there is overlap, the taxpayer will want to choose the more advantageous credit.

Insights

Unlike the general clean vehicle credit, there is no battery or minerals requirement or North America assembly requirement.

Revenue Estimate: ($3.5 billion)

EXTENSION AND MODIFICATION OF ALTERNATIVE FUEL REFUELING PROPERTY CREDIT (IRC § 30C) (IRA § 13404)

Effective Date

Effective for property placed in service after December 31, 2021 and before January 1, 2033.

Current Law

Current law does not provide a credit for alternative fuel vehicle refueling property (i.e., property for the storage or dispensing of clean-burning fuel, including electricity). The credit was available for, among other things, electric vehicle charging supply equipment. Prior to 2022, there was a tax credit for 30% of the cost of any qualified alternative fuel vehicle refueling property installed by a business or at a taxpayer's principal residence. The credit was capped at $1,000 for residential and $30,000 for commercial use (on a per-location basis).

Change

This provision extends the previously expired alternative fuel refueling property credit through 2032, modifying it for property placed in service after 2022.

Beginning in 2023, for businesses, (i) the base credit will be 30% subject to certain prevailing wage and apprenticeship requirements being met, and otherwise reduced by a factor of 5 to 6%, capped at $100,000 per device, (ii) qualifying property will include charging equipment, and (iii) the credit will be limited to property located in a rural or low-income census tract.

Prevailing Wage and Apprenticeship Requirements: All laborers and mechanics employed by the taxpayer (or any contractor or subcontractor) in the construction of any qualified alternative fuel vehicle refueling property must be paid prevailing wages for the location in which the facility is located, as determined by the Secretary of Labor. Additionally, the taxpayer must ensure that at least 15% of labor hours be performed by qualifying apprentices (or 10% or 12.5% for facilities the construction of which begins in 2022 or 2023, respectively). Further, the taxpayer must comply with the applicable apprentice-to-journeyworker ratios set by the Department of Labor. Failure to meet these requirements reduces the credit by a factor of 5.

Insights

While this provision extends the life of the credit, the new census-tract requirement may significantly affect the number of business taxpayers that ultimately claim this credit.

Revenue Estimate: ($1.7 billion)

SUMMARY OF TRANSPORTATION TAX CREDIT PROVISIONS

EXTENSION OF BIODIESEL, RENEWABLE DIESEL AND ALTERNATIVE FUEL CREDITS
(IRC §§ 40A, 6426, 6427)
(IRA § 13201)

Effective Date Effective retroactively and prospectively to fuel sold or used after December 31, 2021.

Current Law The biodiesel, renewable diesel and biodiesel mixture credits against taxable income are set to expire on December 31, 2022. The alternative fuel and alternative fuel mixture credits against excise taxes expired on December 31, 2021.

Change This provision extends the biodiesel, renewable diesel, biodiesel mixture, alternative fuel and alternative fuel mixture credits through December 31, 2024.

Special rules will apply to the one-time submission of claims for tax credits which expired after 2021. The Secretary must provide guidance for claiming these credits. Claims must be submitted within 180 days of the bill's date of enactment.

Insights Taxpayers will expect guidance from Treasury regarding the one-time retroactive application of the credit.

Revenue Estimate: ($5.6 billion)

EXTENSION OF SECOND GENERATION BIOFUEL PRODUCER CREDIT
(IRC § 40)
(IRA § 13202)

Effective Date Effective retroactively and prospectively to fuel sold or used after December 31, 2021.

Current Law The second generation biofuel producer credit expired on December 31, 2021.

Change This provision extends the second generation biofuel producer credit through December 31, 2024.

Insights **Revenue Estimate**: ($54 million)

NEW SUSTAINABLE AVIATION FUEL CREDIT
(IRC § 40B)
(IRA § 13203)

Effective Date Effective for fuel sold or used after December 31, 2022.

Current Law There is no specific aviation fuel tax credit, however, sustainable aviation fuel may be eligible for the biodiesel tax credit.

Change

The new credit is $1.25 per gallon for sustainable aviation fuel that is produced in the United States and that has a lifecycle greenhouse gas emission reduction percentage of 50% over petroleum-based jet fuel, with an additional $0.01 credit for every additional percentage reduction over 50% for a maximum credit amount of $1.75 per gallon.

The credit may be claimed as a tax credit against income tax liability, as a tax credit against excise tax liability or, if there is insufficient excise tax liability, as a refundable credit.

The credit does not apply to any sale or use after December 31, 2024.

Insights

Compared to the prior biodiesel tax credit, the Sustainable Aviation Fuel Credit provides for a larger base credit ($1.50 per gallon for fuels with a 50% emissions reduction relative to conventional fuel) but with the same $1.75 per gallon for fuels with a 100% emissions reduction.

Some commentators have noted that this credit might shift demand for renewable feedstocks, such as vegetable oil, to the aviation industry, indirectly affecting other types of renewable fuel producers' access to renewable feedstocks.

Revenue Estimate: ($49 million)

NEW CLEAN HYDROGEN CREDIT
(IRC § 45V)
(IRA § 13204)

Effective Date

Generally effective for hydrogen produced after December 31, 2022.

Current Law

Prior to 2021, the Code provided a 30% credit for the cost of qualified alternative fuel vehicle refueling property placed in service by a taxpayer, including for fuel at least 85% of the volume of which consists of hydrogen.

Current law does not provide a tax credit for low-carbon hydrogen production.

Change

This provision creates a clean hydrogen production tax credit that applies to each kilogram of qualified clean hydrogen produced by the taxpayer, at a qualified clean hydrogen production facility owned by the taxpayer (construction of which begins prior to January 1, 2033), during the 10-year period beginning on the date such facility is originally placed in service. Further, the production must take place in the United States, at a facility that has a lifecycle greenhouse gas emissions rate of not more than 4 kilograms of CO_2 emissions per kilogram of hydrogen, and occur in the ordinary course of a trade or business of the taxpayer. Finally, the hydrogen must be produced for sale or use, which is verified by an unrelated party.

The base amount of the credit is up to $3.00 per kilogram of qualified clean hydrogen (indexed for inflation). The base amount phases out for production processes that have a lifecycle greenhouse gas emission rate of over 0.45 kilograms of CO_2 emissions per kilogram of hydrogen. The credit amount is reduced by a factor of 5 if prevailing wage and apprenticeship requirements similar to those described above are not met.

Facilities in existence before January 1, 2023 are allowed to claim the credit based on the date such facility is modified to produce qualified clean hydrogen.

The credit can be reduced by up to 15% if the facility is financed with tax-exempt bonds.

The credit will not be allowed for any facility containing carbon capture equipment for which a carbon capture credit is allowed for the taxable year or any prior taxable year.

Insights

While this provision shares many features with the carbon capture and sequestration credit, they are not identical and taxpayers must choose between one or the other.

Revenue Estimate: ($13.2 billion)

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