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Treasury and IRS Release Final Regulations on Section 45X Advanced Manufacturing Production Credit

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The Inflation Reduction Act of 2022 added the Section 45X Advanced Manufacturing Production Credit (Section 45X) to the Internal Revenue Code of 1986, as amended. Section 45X provides a credit against federal income tax for each “eligible component” produced by the taxpayer in the United States and sold to an unrelated person during the tax year (the Section 45X Credit). To qualify for the Section 45X Credit, the taxpayer must be in the trade or business of producing and selling the eligible component. The term “eligible component” includes any solar energy component, wind energy component, inverter, qualifying battery component, and any applicable critical mineral. The taxpayer can also elect to treat a related person as an unrelated person for purposes of selling an eligible component if certain conditions are met. The credit amount varies depending on the type of eligible component and is determined based on the size, weight, capacity, or production costs of the eligible component.

On October 24, 2024, the U.S. Department of Treasury (the Treasury) and the Internal Revenue Service (IRS) released final regulations on Section 45X (the Final Regulations). The Final Regulations provide clarifications to the definitions, eligibility criteria, and procedural requirements of Section 45X initially outlined in proposed Section 45X regulations released on December 15, 2023 (the Proposed Regulations). The Treasury and IRS adopted most of the positions taken in the Proposed Regulations in the Final Regulations except the following changes and clarifications:

Definition of “Production Costs” for Purposes of Calculating the Section 45X Credit

The Proposed Regulations limited the type of expenses that could be included in the definition of “production costs” for purposes of calculating the Section 45X Credit with respect to the production of applicable critical minerals and electrode-active materials. The Final Regulations are broader and allow the inclusion of certain direct and indirect material costs, including the costs related to domestic extraction and retrieval of raw material, if those costs are paid or incurred by the taxpayer claiming the credit and do not include the costs of acquired materials that are already eligible components at time of purchase. Under the Final Regulations, production costs also include direct or indirect material costs incurred by a taxpayer from the acquisition of raw materials regardless of whether the material is sourced domestically or internationally.

Clarification of the Definition of “Produced by the Taxpayer” and Inclusion of Secondary Production for Recycled Materials

To qualify for the Section 45X Credit, eligible components must be “produced by the taxpayer.” The Proposed Regulations defined “produced by the taxpayer” to require a “substantial transformation” by the taxpayer of the constituent elements, materials, or subcomponents into a complete and distinct eligible component. The Final Regulations retain the substantial transformation requirement contained in the Proposed Regulations but expand the definition to include both primary and “secondary production,” defined as producing an eligible component using recycled materials. The Final Regulations state that “minor assembly” by the taxpayer is insufficient to meet the “produced by the taxpayer” requirement, a more accurate interpretation from the “mere assembly” language used in the Proposed Regulations. The Final Regulations also provide that minor assembly steps conducted by third parties do not disqualify an eligible component from the credit if “substantial transformation” of the components occurs as part of the taxpayer’s production process.

Contract Manufacturing Arrangements

The Final Regulations provide guidance on contract manufacturing arrangements, addressing prior ambiguities regarding the substantial transformation requirement. The Proposed Regulations outlined basic contract manufacturing requirements but lacked detailed guidance on how the substantial transformation requirement applied within contract manufacturing contexts. The Final Regulations clarify that parties in such arrangements may designate the credit-claiming entity if the designated party performs a substantial transformation of the eligible component. The Final Regulations provide examples of how these rules apply, including for complex arrangements, like those involving wind towers and battery modules, in which multiple parties contribute to production. The Final Regulations require a “certification statement” signed by both the taxpayer and the contract manufacturer (in the format required by Form 7207) that designates which party may claim the Section 45X Credit.

Interaction between Section 45X and Section 48C

A Section 45X facility cannot produce an eligible component for the Section 45X Credit if the eligible component includes eligible property that has counted toward a Section 48C qualifying advanced energy project credit after August 16, 2022. Under the Proposed Regulations, an eligible component excludes property produced at a facility that incorporates property of which the basis has been included in a Section 48C advanced energy project credit facility and counted toward the credit after August 16, 2022. However, the Final Regulations clarify that a Section 45X Credit can still apply to tangible property used in the facility if that property is independently necessary to produce the eligible components. This means that even if a business claims credit under Section 48C on other property within the same facility, tangible property that undergoes substantial transformation into an eligible component may still qualify for the Section 45X Credit.

Clarification on the Definition of Battery Modules

The Final Regulations for Section 45X clarify the definitions, measurement standards, and documentation requirements for battery cells and modules, building upon the Proposed Regulations. In the Proposed Regulations, “battery module” was defined as a module containing two or more cells configured for a specified end-use or a module without cells, each with a capacity of at least 7 kWh. The Final Regulations clarify that battery modules using cells must integrate the cells into a single module for end-use, with further manufacturing occurring only at the module level, making only the first eligible module in the supply chain eligible for the credit. For battery modules without cells, particularly thermal and thermochemical modules, the Final Regulations require energy storage to be converted to a

kilowatt-hour (kWh) basis, with the methodology and testing consistently applied. This conversion must not exceed the module's total nameplate capacity in kWh, aligning the credit calculation with actual consumer capacity.



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