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Treasury Issues Long-Awaited Wage and Apprenticeship Regulations for Energy Tax Credits

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The Inflation Reduction Act of 2022 introduced significant changes to the renewable energy tax credit landscape. One of the most notable of these changes, in addition to the broader goals of combating climate change and stimulating economic growth, was the introduction of an increased credit amount or rate[1] for taxpayers that satisfy certain prevailing wage and apprenticeship requirements when constructing, altering, and repairing a facility (the "**PWA Requirements**"), facilities on which construction began before January 29, 2023,[2] and facilities with a maximum net output (or capacity) of less than one megawatt. Generally, if one of these three requirements is met, the amount of the credit available is multiplied by five.

The PWA Requirements, which are outlined in the production tax credit ("**PTC**") rules in Code Section 45, consist of two elements: (1) the "**Prevailing Wage Requirements**" and (2) the "**Apprenticeship Requirements.**" Last November, the Internal Revenue Service (the "**IRS**") issued Notice 2022-61 to provide initial guidance on the PWA Requirements.[3] On August 29, Treasury issued much-anticipated proposed regulations (the **"Proposed Regulations**") to expand on the guidance provided in Notice 2022-61. These Proposed Regulations, which are relatively taxpayer-friendly, will allow taxpayers to better navigate the intricacies of compliance with the PWA Requirements and, when necessary, employ corrective measures.

I. The Prevailing Wage Requirements

A. The Prevailing Wage Requirements Generally

Code Section 45 provides that with respect to a facility for which a credit is claimed, the taxpayer must ensure that any laborers and mechanics employed (either by the taxpayer or by any contractor or subcontractor) in the construction, alteration, or repair of the facility are paid wages at rates not less than the prevailing rates for construction, alteration, or repair of a similar character in the locality in which the facility is located as most recently determined by the Secretary of Labor, in accordance with the Davis Bacon Act (the "**DBA**"). For the PTC and for other credits based on production, the wage requirement with respect to the alteration or repair of the facility after the construction has been completed must be satisfied for the duration of the period in which the credit is claimed (10 years in the case of the PTC). For the investment tax credit ("**ITC**"), the qualifying advanced energy project credit, and the clean energy investment credit, the wage requirements with respect to the alteration or repair

of the facility after the construction has been completed must be satisfied for the five-year recapture period.

The Proposed Regulations largely incorporate DBA statutory and regulatory guidance that Treasury has determined is relevant for purposes of claiming an increased tax credit, including the definitions of certain terms and determining the prevailing wage rates.

1. Definitions

The Proposed Regulations include a number of definitions:

- "*Laborers*" and "*mechanics*" are those individuals whose duties are manual or physical in nature (including those individuals who use tools or who are performing the work of a trade), including apprentices and helpers.

- "*Construction, alteration, or repair*" will generally mean "construction, prosecution, completion, or repair" as defined in 29 CFR 5.2. This includes all work done on a particular building or work at the site thereof, including on-site installation, on-site-manufacturing, and transportation between the site of work and an off-site facility dedicated to the construction of the building. For these purposes, the site of the work includes secondary construction sites where a significant portion of the construction, alteration, or repair work occurs and that are established specifically for (or dedicated exclusively for a specific period of time) the construction, alteration, or repair of the facility. The Proposed Regulations also explain that work designed to maintain and preserve a facility's functionality, such as janitorial work, replacing minor materials with limited lifespans, and equipment calibration, is not "construction, alteration, or repair," but only for such work that is completed after a facility is placed in service.

- "*Wages*" will generally mean "wages" as defined in 29 CFR 5.2, and thus will include the basic hourly rate of pay; any contribution irrevocably made by a taxpayer, contractor or subcontractor to a trustee or to a third person under a bona fide fringe benefit fund, plan, or program, and the rate of costs to the taxpayer, contractor or subcontractor which may be reasonably anticipated in providing bona fide fringe benefits to laborers and mechanics under an enforceable commitment to carry out a financially responsible plan of program, which was communicated in writing to the laborers and mechanics affected.

- "*Employed*" means performing the duties of a laborer or mechanic for the taxpayer, contractor, or subcontractor (as applicable), regardless of whether the individual would be characterized as an employee or an independent contractor for other federal tax purposes.

- "*Contractor*" means any person that enters into a contract with the taxpayer for the construction, alteration, or repair of a qualified facility.

- "*Subcontractor*" means any contractor that agrees to perform or be responsible for the performance of any part of a contract entered into with the taxpayer (or the taxpayer's contractor) with respect to the construction, alteration, or repair of a facility.

Because many of these definitions are borrowed from the regulations promulgated by the DOL under the DBA (which is a labor statute), many of these definitions differ from the same terms used in other areas of tax law.

2. Determining the Prevailing Wage Rate

Under the Proposed Regulations, prevailing wage rates are determined by the DOL in accordance with the DBA when they are issued and published by the DOL as a general wage determination (or as part of a supplemental wage determination or a request for a wage rate for an additional classification). The Proposed Regulations also include a taxpayer-friendly provision, which states that although taxpayers must use the general wage determination in effect when the construction of a facility begins, taxpayers are not required to update those rates during the course of construction if a new general wage determination is published. However, if a contract is modified to (i) include additional, substantial construction, alteration, or repair work not within the scope of the work in the original contract or (ii) require work be performed for an additional time period not originally obligated (including where an option to extend the term of the contract is exercised), a new general wage determination would be required at the time the modification of the contract takes place. After a facility is placed in service, the applicable wage rate used must be the general wage determination in effect when the alteration or repair work begins.

General wage determinations. The Proposed Regulations explain that a general wage determination is one issued and published by the DOL that includes a list of wage and bona fide fringe benefit rates determined to be prevailing for laborers and mechanics for the classifications of work performed with respect to a specified type of construction in a geographic area. These are currently available at https://www.sam.gov.

Special procedures when there is no applicable general wage determination. The Proposed Regulations also include special procedures for the limited circumstances in which a general wage determination does not provide an applicable wage rate for work performed on the facility, although the IRS has indicated that the DOL has advised that most taxpayers will likely not need to use these procedures. Nevertheless, in these circumstances, a taxpayer, contractor, or subcontractor must request a supplemental wage determination or a prevailing wage rate for an additional classification from the DOL. These procedures correspond to those included in the regulations promulgated by the DOL under the DBA and are consistent with those described in IRS Notice 2022-61. The Proposed Regulations also adopt the review and appeal procedures available under the DBA with respect to such wage determinations.

Facilities that straddle multiple geographic areas. Identifying that some facilities may span multiple geographic areas, Treasury has provided in the Proposed Regulations that a taxpayer will satisfy the Prevailing Wage Requirements by paying laborers and mechanics wages at the highest rate for each classification provided under the general wage determination. A taxpayer would also be able to request a supplemental wage determination to address this issue.

Offshore facilities. The Proposed Regulations provide that for offshore facilities, in lieu of requesting a supplemental wage determination, a taxpayer, contractor, or subcontractor may rely on the general wage determination applicable to the geographic area closest to the facility's location.

Wages for apprentices. The Proposed Regulations allow the payment of wages that differ from the applicable prevailing wage rate to apprentices who are participating in a registered apprenticeship program, as demonstrated by a written apprenticeship agreement containing certain terms and conditions required by the DOL. The rate for such apprentices must be determined under the regulations promulgated under the DBA.

B. Correction and Penalty Payments for Failure to Satisfy the Prevailing Wage Requirements

If a facility does not qualify for the BOC Exception or the One Megawatt Exception and if the taxpayer fails to satisfy the Prevailing Wage Requirements, Code Section 45 provides taxpayers with an ability to correct this failure. To do so, the taxpayer must, for any laborer or mechanic who was paid wages at less than the required prevailing rate, make a correction payment to that laborer or mechanic and pay a penalty to the IRS. The amount of a correction payment is the difference between the amount of wages actually paid to the laborer or mechanic and the amount of wages that should have been paid to the laborer or mechanic under the Prevailing Wage Requirements, plus interest (which amount is tripled in the case of intentional disregard). The amount of the penalty payment is $5,000 per laborer or mechanic ($10,000 in the case of intentional disregard) paid wages below the prevailing wage rate. Any correction and penalty payments must be made by the taxpayer on or before the date that is 180 days after a final determination by the IRS with respect to the taxpayer's failure to satisfy the Prevailing Wage Requirements.

When correction and penalty payments must be made. The Proposed Regulations clarify that taxpayers are obligated to make correction payments to any laborer or mechanic on or before the date a return is filed claiming an increased credit amount based on the PWA Requirements (however, that obligation does not become binding until such an increased credit amount is claimed on a tax return). Taxpayers may want to make correction payments earlier in order to limit the additional interest that must be paid. In addition, the penalty payment is owed at the time the return is filed claiming the increased credit amount. The Proposed Regulations also echo the statutory 180-day deadline for the taxpayer's ability to use the correction and penalty provisions to rectify a failure to comply with the Prevailing Wage Requirements when the IRS makes a final determination that those requirements were not satisfied.

No exceptions for failure to locate laborers and mechanics owed correction payments. Although the Treasury recognizes that facilities may be constructed over several years and thus some taxpayers may be unable to locate all laborers and mechanics to which correction payments must be made, the Proposed Regulations do not excuse taxpayers from the requirement to make a correction payment even if such laborer or mechanic cannot be found. Treasury has requested comments concerning appropriate rules for such situations. In the meantime, taxpayers will want to ensure that construction contracts contain adequate provision-of-information and information retention covenants to allow laborers and mechanics to be located in the event that the Prevailing Wage Requirements are not met.

Exceptions when a supplemental wage determination or prevailing wage rate for an additional classification is pending. Recognizing the possibility that the DOL's response to a supplemental wage determination or a prevailing wage rate for an additional classification may not be issued until after laborers and mechanics have begun work on a facility, the Proposed Regulations provide that a taxpayer will not fail to meet the Prevailing Wage Requirements for any laborers or mechanics whose wage rates are subject to that request and were paid below the prevailing wage rate, provided that a correction payment is made within 30 days of that determination.

Application to tax credit transfers. For purposes of tax credit transfers under Code Section 6418, the Proposed Regulations clarify that the requirement to make correction and penalty payments continues to apply to the eligible taxpayer who transfers the credit. However, if the eligible taxpayer fails to make the correction or penalty payments, any resulting disallowance of the increased credit amount would impact the transferee taxpayer. Thus, for facilities that qualify for the increased credit amount based on

the PWA Requirements, tax credit transferees will want to seek covenants in any tax credit transfer agreements requiring the transferor to timely make any such correction and penalty payments.

Intentional disregard. If the IRS determines that a failure to pay prevailing wage rates is due to intentional disregard, the amount of the correction payment is tripled, and the amount of the penalty payment is doubled. The Proposed Regulations explain that such a failure is due to intentional disregard if it is knowing or willful. This requires consideration of the relevant facts and circumstances, a non-exhaustive list of which is included in the Proposed Regulations. These include, among others, whether the failure was part of a pattern of conduct, whether the taxpayer failed to take steps to determine the applicable classifications and prevailing wage rates for laborers and mechanics, whether the taxpayer promptly cured any noncompliance, whether the taxpayer undertook a quarterly or more frequent review of wages paid, and whether the taxpayer included contractual provisions requiring payment of prevailing wages. In addition, the Proposed Regulations provide a rebuttable presumption against a finding of intentional disregard if the taxpayer makes the correction and penalty payments before receiving a notice of examination. This presumption has been included to encourage taxpayers to take corrective actions upon discovering a compliance failure.

Exception for project labor agreements. The Proposed Regulations provide that the penalty payment required to cure a failure to satisfy the Prevailing Wage Requirements does not apply with respect to a laborer or mechanic employed in the construction, alteration, or repair work of a qualified facility if the work is done pursuant to a pre-hire collective bargaining agreement with one or more labor organizations that establishes the terms and conditions of employment for a specific construction project (a "**Qualifying Project Labor Agreement**") and any correction payment owed to any laborer or mechanic is paid on or before the date on which the increased credit is claimed on a tax return.

II. Apprenticeship Requirements

A. The Apprenticeship Requirements Generally

Code Section 45 outlines three components required to satisfy the Apprenticeship Requirements: a labor hours requirement, a ratio requirement, and a participation requirement. For purposes of these requirements, a "qualified apprentice" is an individual employed by the taxpayer or by any contractor or subcontractor and who is participating in a registered apprenticeship program.[4]

1. Labor Hours Requirement

First, with respect to the construction of the facility, not less than the applicable percentage of the total labor hours of the construction, alteration, or repair work (including that performed by any contractor or subcontractor) performed on the facility must be performed by qualified apprentices (the "**Labor Hours Requirement**"). For a facility that begins construction in 2023, the applicable percentage is 12.5%, and for a facility that begins construction in 2024 or later, the applicable percentage is 15%.[5] Code Section 45 defines "labor hours" to mean the total number of hours devoted to the performance of construction, alteration, or repair work by any individual (whether employed by the taxpayer or by any contractor or subcontractor), but excluding any hours worked by foremen, superintendents, owners, or persons employed in a bona fide executive, administrative, or professional capacity. The Proposed Regulations reiterate these requirements.

2. Ratio Requirement

Second, the Labor Hours Requirement is subject to any Department of Labor ("**DOL**") or applicable state apprenticeship agency requirements for apprentice-to-journeyworker ratios (the "**Ratio**

Requirement"). The Proposed Regulations explain that the applicable ratio would need to be adhered to daily during the construction, alteration, or repair of the facility. Moreover, if the Ratio Requirement is not met on any particular day, any apprentices in excess of the applicable ratio who perform work on that day must be paid the full prevailing wage rate for purposes of the Prevailing Wage Requirement, and the hours worked by those apprentices will not be counted as apprentice hours for purposes of the Labor Hours Requirement. For purposes of the Ratio Requirement, the Proposed Regulations define a "journeyworker" as laborer or mechanic who has attained a level of skill, abilities and competencies recognized within an industry as having mastered the skills and competencies required for the occupation. This definition is adopted from regulations promulgated by the DOL.

3. Participation Requirement

Finally, any taxpayer, contractor, or subcontractor who employs four or more individuals to perform construction, alteration, or repair work with respect to the construction of a facility must employ one or more qualified apprentices to perform the work. Treasury explained in the preamble to the Proposed Regulations that the purpose of this rule is to encourage taxpayers to use apprentices across the full range of work performed with respect to a facility rather than hiring them to perform only one type of work. The Proposed Regulations clarify that unlike the Ratio Requirement, this is not a requirement that must be satisfied each calendar day.

B. Good Faith Effort Exception to the Apprenticeship Requirements

Code Section 45 contains an exception for failure to satisfy the Apprenticeship Requirements, which was clarified in IRS Notice 2022-61. A taxpayer will be deemed to satisfy the Apprenticeship Requirements if the taxpayer has requested qualified apprentices from a registered apprenticeship program in accordance with usual and customary business practices for registered apprenticeship programs in a particular industry and either (i) the request has been denied (other than a denial resulting from the taxpayer's, contractor's, or subcontractor's refusal to comply with the established standards and requirements of the program), or (ii) the registered apprenticeship program fails to respond to the request within five business days after receiving the request (the "**Good Faith Effort Exception**").

Request for qualified apprentices. The Proposed Regulations explain that to satisfy the Good Faith Effort Exception, the taxpayer, contractor, or subcontractor must submit a written request for qualified apprentices to at least one registered apprenticeship program that (i) has a geographic area of operation that includes (or that can be reasonably expected to provide apprentices to) the facility's location, (ii) trains apprentices in the occupation needed to perform the applicable work on the facility, and (iii) has a usual and customary business practice of entering into agreements with employers for the placement of apprentices in the occupation for which they are training. The request must be in writing, sent electronically or by registered mail, and must contain certain information, including the proposed dates of employment, occupation of and number of apprentices needed, the location of the work to be performed, and the expected number of labor hours to be performed.

Denial of request. In cases where a taxpayer's, contractor's, or subcontractor's request for a qualified apprentice is denied, the Proposed Regulations require that the taxpayer, contractor, or subcontractor must submit an additional request within 120 days to qualify for the Good Faith Effort Exception. In addition, the denial of a request is only valid for purposes of establishing the Good Faith Effort Exception with respect to the portions of the request that were denied.

Failure to respond. The Proposed Regulations clarify that an acknowledgement (whether in writing or otherwise) of receipt of a request by a registered apprenticeship program is sufficient response for

purposes of determining whether a registered apprenticeship program has responded to a taxpayer, contractor, or subcontractor's request.

C. Cure Payment for Failure to Satisfy the Apprenticeship Requirements

Like the Prevailing Wage Requirements, Code Section 45 provides a cure provision for failure to satisfy the Apprenticeship Requirements. If the taxpayer fails to satisfy the Labor Hours Requirement or the Participation Requirement (and if the Good Faith Effort Exception doesn't apply), the taxpayer must make a penalty payment to the IRS in an amount equal to $50 ($500 for intentional disregard) multiplied by the total labor hours for which the Labor Hours Requirement or the Participation Requirement was not satisfied with respect to the construction, alteration, or repair work on the facility.

The Proposed Regulations explain that the total labor hours for which the Labor Hours Requirement was not satisfied is equal to the difference between (i) the total labor hours that would be required to meet the applicable percentage and (ii) the total labor hours actually worked by qualified apprentices consistent with the Ratio Requirement. In addition, the total labor hours for which the Participation Requirement was not satisfied is equal to (i) the total labor hours of construction, alteration, or repair worked by all individuals employed by the taxpayer, contractor, or subcontractor who failed to meet the Participation Requirement of the qualified facility, divided by (ii) the number of individuals employed by the taxpayer, contractor, or subcontractor who performed construction, alteration, or repair work on the facility.

Application to tax credit transfers. For purposes of tax credit transfers under Code Section 6418, the Proposed Regulations clarify that the requirement to make penalty payments continues to apply to the eligible taxpayer who transfers the credit. However, if the eligible taxpayer fails to make the penalty payment, any resulting disallowance of the increased credit amount would impact the transferee taxpayer. Thus, for facilities that qualify for the increased credit amount based on the PWA Requirements, tax credit transferees will want to seek covenants in any tax credit transfer agreements requiring the transferor to timely make any such penalty payments.

Intentional disregard. If the IRS determines that a failure to satisfy the Apprenticeship Requirements is due to intentional disregard, the penalty payment is multiplied by ten. The Proposed Regulations provide that a failure would be due to intentional disregard if it is knowing or willful, considering all relevant facts and circumstances. In addition, Treasury has included in the Proposed Regulations a non-exhaustive list of facts and circumstances to be considered in determining whether such a failure is due to intentional disregard, including whether the failure was part of a pattern of conduct, whether the taxpayer took steps to determine the applicable percentage of labor hours required to be performed by qualified apprentices, whether the taxpayer promptly sought to cure any failures, and whether the taxpayer included contractual provisions requiring compliance with the Apprenticeship Requirements. As with the Prevailing Wage Requirements, if a taxpayer makes the penalty payment before receiving an IRS notice of examination, there is a rebuttable presumption against intentional disregard.

Exception for project labor agreements. The penalty payment required to cure a failure to satisfy the Apprenticeship Requirements is waived for facilities under a Qualifying Project Labor Agreement, offering flexibility for specific labor arrangements.

III. Next Steps: Comment Period, Public Hearing & Future Guidance

Treasury and the IRS encourage stakeholders to submit comments on the Proposed Regulations by October 30, 2023, with a public hearing scheduled for November 21, 2023. After the comment period

closes and taxpayers have been given an opportunity to be heard at the public hearing, Treasury and the IRS will assess whether revisions to the Proposed Regulations are necessary. In the meantime, the Proposed Regulations provide taxpayers, contractors, and subcontractors constructing renewable energy projects with greater certainty as to their employment-related obligations.

Understanding and complying with the PWA Requirements are vital steps toward ensuring qualification for increased credits, and staying informed and engaged during the comment period and public hearing can help shape future guidance in this evolving landscape.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Los Angeles lawyers:

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[1] The increased credit amount or rate is available for the following credits: the alternative fuel credit (Section 30C), the production tax credit (Section 45), the new energy efficient homes credit (Section 45L), the credit for carbon oxide sequestration (Section 45Q), the nuclear power production credit (Section 45U), the clean hydrogen production credit (Section 45V), the clean electricity production credit (Section 45Y), the clean fuel production credit (Section 45Z), the investment tax credit (Section 48), the qualifying advanced energy project credit (Section 48C), and the clean energy investment credit (Section 48E).

[2] On November 30, 2022, the Treasury Department and the IRS issued Notice 2022-61, which provided guidance for determining the beginning-of-construction date of a facility for purposes of the credits available under Code Sections 30C, 45, 45Q, 45V, 45Y, 48, and 48E.

[3] For a general discussion on Notice 2022-61, see our prior Client Alert, IRS Publishes Initial Tax Credit Guidance on Prevailing Wage and Apprenticeship Requirements.

[4] A "registered apprenticeship program" is defined in Code Section 3131(e)(3)(B) as an apprenticeship program registered under the National Apprenticeship Act that meets certain standards set forth in the Code of Federal Regulations.

[5] The statute also provides that for facilities that began construction prior to 2023, the applicable percentage is 10%. However, those facilities would be able to qualify for the 5x multiplier under the exclusion from the PWA Requirements for facilities on which construction began before January 29, 2023, and thus would not need to satisfy the PWA requirements.