Updates
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IRS Issues Fact Sheet for New Federal Clean Vehicle Tax Credits

The Internal Revenue Service (IRS) published a fact sheet on December 29, 2022, clarifying changes in federal clean vehicle tax credits enacted through the Inflation Reduction Act (IRA) in August 2022. Through a detailed question-and-answer format, the IRS seeks to help consumers and businesses understand and access the new clean vehicle tax benefits, the bulk of which are now effective as of January 1, 2023. The IRS has not yet finalized guidance related to the "critical mineral" and battery component requirements for new passenger vehicle tax credits.

Individuals and businesses in the market for a new or used passenger vehicle or qualifying commercial vehicle should review the new IRS fact sheet and supporting information closely. The new federal tax credit structure marks a significant departure from the prior tax credit regime. Eligibility depends on multiple factors, including timing of purchase and delivery, final assembly location, income, and manufacturer's suggested retail price (MSRP).

Background

On August 16, 2022, President Biden signed into law the IRA, which, among many other provisions, modified existing tax credits for clean vehicles (i.e., plug-in electric and fuel cell electric vehicles) in Section 30D of the Internal Revenue Code (IRC). The IRA also added two new tax credits: used passenger vehicles (Section 25E) and commercial vehicles (Section 45W).

Prior to the IRA, new passenger vehicles were eligible for up to a $7,500 tax credit, subject to a 200,000 cap on the total number of vehicles by manufacturer. The IRA eliminated the manufacturer cap but added several other eligibility requirements. Notably, for new passenger vehicles, eligibility for the maximum $7,500 credit now depends on how the vehicle's battery was manufactured. The credit represents the sum of two amounts: $3,750 if the battery meets critical mineral requirements and $3,750 if the battery meets certain component requirements. The battery requirements are set to increase in stringency each year.

Fact Sheet Clarifications

The new IRS fact sheet answers tax credit implementation questions for each of the three now-eligible vehicle categories: (1) new passenger vehicles, (2) used passenger vehicles, and (3) commercial vehicles. The IRS cautions that the fact sheet is subject to modification and is only intended to provide general information to taxpayers and tax professionals as quickly as possible. The fact sheet was not published in the *Internal Revenue Bulletin* (IRB) and therefore will not be relied on by the IRS to resolve a case. Ultimately, the law controls taxpayer liability, but taxpayers who rely on the fact sheet reasonably and in good faith will not be subject to penalty to the extent it results in underpayment of tax. Key clarifications regarding the IRA's tax credits for clean vehicles are as follows:

New Passenger Vehicles

The fact sheet clarifies which vehicles qualify for the new passenger vehicle credit. Eligible vehicles include plug-in electric and fuel cell electric vehicles that, among other requirements, a taxpayer purchases from a qualified manufacturer for "original use" (meaning the vehicle has never been used by any taxpayer for any purpose) with final assembly completed in North America (including the United States and Puerto Rico, Canada, and Mexico). Sellers must comply with new IRS reporting requirements, and the purchase is subject to both income and MSRP limitations. The IRS maintains a list of eligible vehicles, which is expected to evolve as new information becomes available. The new credit can only be claimed in the tax year that the vehicle is "placed in service," meaning the tax year that delivery takes place (even if the vehicle was purchased in a prior year). Vehicles purchased prior to January 1, 2023, are subject to a different set of transitional provisions.

Until the IRS proposes guidance on the critical mineral and battery component requirements of the IRA (anticipated in March 2023), the maximum $7,500 credit value will be calculated using an interim method: a $2,500 base amount plus, for a vehicle that draws propulsion energy from a battery with at least five kilowatt-hours (kWh) of capacity, $417, plus an additional $417 per kWh of battery capacity above five kWh. When the new proposed guidance is issued, the credit amount will depend on whether the vehicle meets the critical minerals requirement ($3,750) and/or the battery components requirement ($3,750), as required by the IRA.

Used Passenger Vehicles

The IRA created a new tax credit of up to $4,000 for the purchase of used passenger vehicles with a sale price of $25,000 or less. To claim the credit, the buyer must meet certain income limitations, and it must be the vehicle's first sale since August 16, 2022 (the date of enactment of the IRA). The model year of the used vehicle must be at least two years earlier than the calendar year in which the taxpayer acquires the vehicle, and the used vehicle must be purchased from a dealer. Only individuals are eligible for the credit; business entities do not qualify.

Commercial Vehicles

The IRA also created a tax credit for commercial vehicles acquired for "use or lease" by the taxpayer (i.e., not for resale). The amount of the credit is the lesser of 15% of the taxpayer's tax basis in the qualified commercial clean vehicle (30% in the case of a vehicle not powered by a gasoline or diesel internal combustion engine) or the incremental cost of the vehicle. The credit is limited to $7,500 total for vehicles that weigh less than 14,000 pounds, and $40,000 for all other vehicles. Concurrent with the fact sheet, IRS issued a safe harbor with guidance on how to calculate "incremental cost" for the 2023 tax year. In short, the incremental cost of a qualified commercial clean vehicle is the excess of the purchase price of such vehicle over the price of a comparable vehicle, which the IRS defines as any vehicle that is powered solely by a gasoline or diesel internal combustion engine and that is comparable in size and use to that qualified commercial clean vehicle.

Prior to publication of the IRS fact sheet, questions circulated about whether the commercial credit (which is not subject to the same battery sourcing requirements as new passenger vehicle purchases) can be claimed for leased vehicles. In mid-December 2022, Senator Joe Manchin sent a letter to U.S. Secretary of the Treasury Janet Yellen cautioning that this interpretation, which would create a way to "bypass the strict sourcing requirements," was not the intent of the IRA. However, applying longstanding principles of tax law, the IRS states that the question of who is eligible to claim the credit (the owner or the lessee) depends on whether the lease is respected as a lease or recharacterized as a sale for federal income tax purposes.

Next Steps

Practitioners, businesses, and consumers should expect to hear more from the IRS on implementation of the new vehicle tax credits in coming months. One significant open item, referenced above, is the calculation of the new passenger vehicle credit based on the critical mineral and battery component requirements. For now, the IRS has issued a white paper summarizing its anticipated direction on this important requirement. The IRS anticipates announcing this proposed guidance, as part of a package of proposed regulations, in March 2023.

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