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Legal Update

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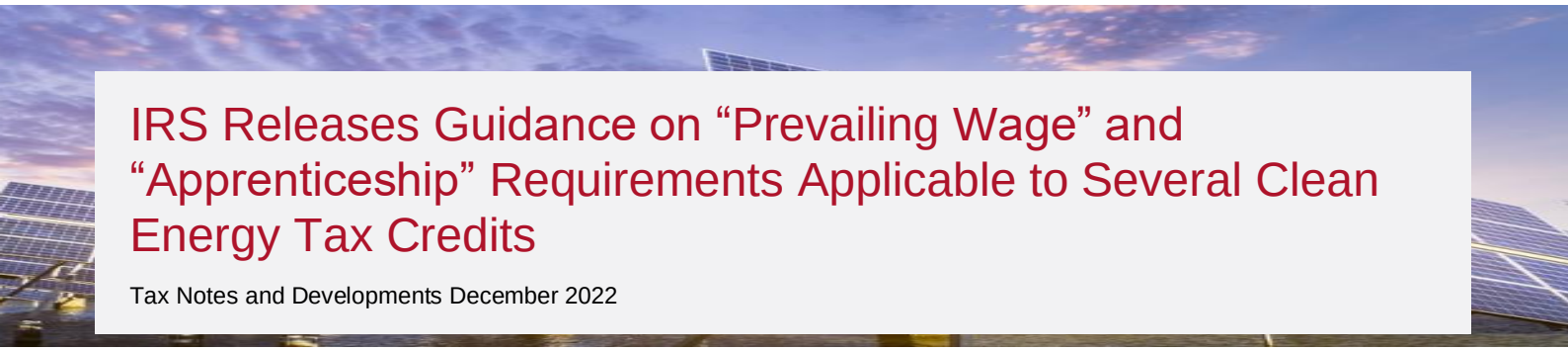

IRS Releases Guidance on "Prevailing Wage" and "Apprenticeship" Requirements Applicable to Several Clean Energy Tax Credits

Tax Notes and Developments December 2022

In Brief

On 30 November 2022, the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") published Notice 2022-61 (the "Notice"), which provides much-awaited guidance on the application of "prevailing wage" and "apprenticeship" requirements relevant to determining the amount of several renewable energy and other clean technology tax credits that were enacted, extended or modified by the Inflation Reduction Act ("IRA"). The guidance provided by the Notice is fairly scant and leaves a number of issues unaddressed. It seems that the issuance of the Notice was rushed in order to start the 60-day period prior to the end of which the construction of credit-eligible projects must begin in order for the "prevailing wage" and "apprenticeship" requirements to be deemed satisfied. The Notice explicitly states that it constitutes the guidance that starts this 60-day clock pursuant to the IRA. Thus, taxpayers will need to actually satisfy the "prevailing wage" and "apprenticeship" requirements, to the extent applicable, for projects the construction of which begins on or after 29 January 2023, in order to be eligible to claim the maximum amount of tax benefits for which they qualify.

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Key Takeaways

- The Inflation Reduction Act added "prevailing wage" and "apprenticeship" requirements for certain facilities that qualify for tax credits available for renewable energy production and certain other "clean" and advanced technologies. A credit-eligible facility must satisfy these requirements in order to qualify for the highest amount of tax credits available.
- Pursuant to the IRA, credit-eligible facilities are generally deemed to automatically satisfy the "prevailing wage" and "apprenticeship" requirements if their construction begins before the date that is 60 days after Treasury issues guidance on these requirements. Notice 2022-61 purports to be that guidance, and therefore starts that 60-day period. Taxpayers must begin construction of credit-eligible facilities before 29 January 2023 in order to be deemed to have automatically satisfied the prevailing wage and apprenticeship requirements with respect to those facilities.
- Notice 2022-61 clarifies when construction is deemed to begin on a qualified facility for purposes of the deemed satisfaction of the "prevailing wage" and "apprenticeship" requirements. Further, it details how to actually satisfy these requirements if construction begins on or after the deadline.
- To satisfy the prevailing wage requirements, taxpayers must classify work done by all manual laborers, and ensure that those laborers are paid a prevailing rate for the locality in which the work is performed. This rate is determined by the Department of Labor, and if the rate is not yet published, the onus is on the taxpayer to contact the Department of Labor to determine the applicable rate.
- To meet the apprenticeship requirements, taxpayers must ensure that a certain percentage of the total labor hours spent on the construction, alteration, or repair of a qualified facility is performed by qualified apprentices. A taxpayer must also ensure that, if the taxpayer, a contractor, or a subcontractor employs four or more individuals, that employer must also employ at minimum one apprentice. However, there is a good faith exception to these apprenticeship requirements.

- Construction of a qualified facility is deemed to begin either when (i) physical work of a significant nature begins with respect to the facility, provided that the taxpayer maintains a "continuous program of construction" until the facility is completed, or (ii) the taxpayer pays or incurs five percent of the total cost of the qualified facility, provided that the taxpayer thereafter makes "continuous efforts" to advance towards completion of the facility. The continuity element of these two requirements is deemed to be automatically satisfied if the applicable facility is placed in service prior to an applicable deadline. If construction of a facility is deemed to begin before 29 January 2023, the prevailing wage and apprenticeship requirements with respect to that facility are deemed to be automatically satisfied. The beginning of construction rules are essentially the same as rules that were previously applicable prior to the enactment of the IRA, when the beginning of construction date was relevant to determining the amount of certain credits for which a facility could qualify in instances in which those credits were subject to phase-out over time.

The Inflation Reduction Act Changes the Tax Credit Landscape

On 16 August 2022, President Biden signed the IRA into law. In order to encourage wide-scale adoption of and investment in the technologies required to accelerate the energy transition away from fossil fuels and to reduce greenhouse gas emissions, the IRA expanded the availability of certain tax incentives, most notably tax credits, for these technologies, by making new technologies and activities eligible for these tax incentives, generally extending the period of time for which these incentives are available, and, in some instances, increasing the amount of the available incentives.

In parallel, to encourage taxpayers that intend to place into service facilities eligible for these tax incentives to appropriately compensate the laborers who will construct them, the IRA added certain "prevailing wage" and "apprenticeship" requirements. Taxpayers must ensure that these requirements are satisfied (or deemed satisfied) in order to be eligible for the highest amount of available incentives. In general, the IRA provides a "base" tax credit amount for eligible technologies, but taxpayers can claim an enhanced tax credit equal to five times that amount with respect to the qualifying facility if the "prevailing wage" and "apprenticeship" requirements are met.[1]

In addition, the IRA generally provides that so long as construction of the relevant qualified facility begins prior to the date that is 60 days after Treasury issues guidance on the prevailing wage and apprenticeship requirements, those requirements will be deemed automatically satisfied with respect to that facility, and therefore the taxpayer will automatically be eligible for the higher amount of the applicable tax benefit. Thus, the publication of the Notice purports to start this 60-day period which will end on 29 January 2023. Projects the construction of which is not deemed to begin before that date will not be deemed to automatically satisfy the "prevailing wage" and "apprenticeship" requirements/

The Notice provides taxpayers with additional guidance in three main areas: (1) how to compensate certain laborers, and how to keep appropriate records to satisfy the "prevailing wage" requirements, (2) how to satisfy the "apprenticeship" requirements by employing qualified apprentices, and to what extent they must be employed, and (3) how to determine if construction of a qualified facility has begun.

The "prevailing wage" and "apprenticeship" requirements apply to credits and deductions available under the following provisions of the Internal Revenue Code:

- Section 30C: Tax credit for alternative fuel vehicle refueling property
- Section 45: Tax credit for electricity produced from certain renewable resources
- Section 45L: Tax credit for new energy efficient homes

[1] For example, the "base" rate for the production tax credit under section 45 and the investment tax credit under section 48, after modification by the IRA is one-fifth of the previously-applicable credit amount before the IRA's enactment without regard to any phase-out. Thus, after modification by the IRA, in order to claim the same amount of credit as was previously available with respect to any project that is eligible for either credit, taxpayers must meet the "prevailing wage" and "apprenticeship" requirements. In addition, the IRA modified these credits to provide some additional enhancements to the applicable credit amount if the project meets a certain "domestic content" threshold or if it is located in a so-called "energy community."

- Section 45U: Tax credit for zero-emission nuclear power production[2]
- Section 45Z: Tax credit for clean fuel production[3]
- Section 45Q: Tax credit for carbon oxide sequestration
- Section 45V: Tax credit for production of clean hydrogen
- Section 45Y: Tax credit for clean electricity production
- Section 48: Tax credit for energy property
- Section 48C: Tax credit for qualifying advanced energy projects
- Section 48E: Tax credit for clean electricity investment
- Section 179D: Deduction for energy efficient commercial buildings.

The IRA added "prevailing wage" and "apprenticeship" requirements to each of the above listed benefits. Taxpayers must therefore satisfy (or be deemed to automatically satisfy) these requirements to obtain the full value of the applicable tax benefit for the applicable credit-eligible activity or property.

Prevailing Wage Requirements and How to Satisfy Them

Pursuant to the statutory language of the IRA, in order to meet the "prevailing wage" requirement, taxpayers must ensure that any "laborers" and "mechanics" involved in the "construction" of a qualified facility eligible for a tax credit or other benefit for which the requirement is relevant, or any such "laborers" or "mechanics" involved in the repair or alteration of the facility for a period of time after it is originally placed in service, are appropriately compensated. This requirement applies not only to laborers or mechanics that are employed or independently contracted by the taxpayer, but also to those employed or independently contracted by a contractor or subcontractor. Therefore, taxpayers must ensure that agreements with contractors provide for appropriate compensation of the laborers and mechanics used by that contractor and by any subcontractors.

The Notice defines a "laborer" or "mechanic" by reference to 29 C.F.R. § 5.2(m) as a worker whose duties are manual or physical in nature (including those workers who use tools or who are performing the work of a trade), as distinguished from individuals whose work is knowledge-based or managerial in nature. Thus, workers whose duties are primarily administrative, executive, or clerical, or persons employed in a bona fide executive, administrative, or professional capacity are not subject to these rules. Apprentices, trainees, and helpers can be laborers or mechanics.

To appropriately compensate a laborer, that laborer must be paid a "prevailing rate" for the construction, alteration, or repair work ("CAR Work") of a similar character in the locality where the work is performed. This "prevailing rate" is determined by the Secretary of Labor.

The Notice clarifies how to determine the relevant prevailing rate and to whom it must paid. Essentially, the taxpayer must ensure that: (1) laborers and mechanics are paid the correct rate for their work, and (2) appropriate records are kept to show that they are so paid.

Ensuring the Correct Wage is Paid for the Applicable Work

The first step in satisfying the requirements is to identify the correct rate for the services provided. A single laborer can perform different types of services. Accordingly, taxpayers should ensure that the "prevailing wage" requirement is met with respect to a laborer's work depending on the type of work performed, rather than assign an overall status to the laborer.

The taxpayer should first determine whether the laborer needs to be paid a prevailing wage rate. Taxpayers must ensure the payment of a prevailing wage only for work involved in connection with the construction of a qualified facility, and for some time

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2 Only the prevailing wage requirement, and not the apprenticeship requirement, applies to the section 45U tax credit.

3 The prevailing wage requirement applies only to alteration and repair, and not construction, of qualified property for purposes of the section 45Z tax credit.

after that facility is originally placed into service, the facility’s repair or alteration. CAR Work for which laborers must be paid a prevailing wage rate is defined by reference to 29 C.F.R. § 5.2(j). CAR Work includes all work done on a particular facility or the site thereof by any laborers or mechanics employed by a construction contractor or subcontractor. This includes, but is not limited to: (1) altering and remodeling, (2) installing items fabricated off-site, (3) painting and decorating, (4) manufacturing or furnishing materials, articles, supplies, or equipment on the site of the facility, (5) transporting materials, articles, supplies, or equipment between the site of the work and a secondary site dedicated to the construction, alteration, or repair of the facility, and (6) transporting portion(s) of the facility between a site where a “significant” portion of the facility is constructed and the physical site(s) where the facility will remain.

If a laborer or mechanic does not perform CAR Work, or does so after the applicable period following the date the qualified facility is placed in service, the taxpayer need not ensure that the laborer is paid a prevailing wage.

Second, the taxpayer should determine the locality in which the work is performed. Third, the taxpayer should determine what type of work the laborer is to perform. Fourth, the taxpayer should visit www.sam.gov to determine if the Department of Labor has published a wage determination for that type of work in the applicable locality.

If the Department of Labor has not published a wage determination, the taxpayer—not the Department of Labor or the IRS—must begin the process of determining the appropriate wage. To do so, the taxpayer must contact the Department of Labor, Wage and Hour Division, through email at IRAprevailingwage@dol.gov and provide the Wage and Hour Division with information regarding (1) the type of facility, (2) its location, (3) proposed labor classifications, (4) proposed prevailing wage rates, (5) related job descriptions and duties, and (6) any rationale for the proposed labor classifications. After review, the Wage and Hour Division will notify the taxpayer as to the appropriate labor classification and corresponding prevailing wage for the type of work in question for the locality in which the facility is located.

Finally, the taxpayer should ensure that any and all laborers or mechanics performing CAR Work are in fact paid the prevailing wage, regardless of who employs or contracts them, contractors and subcontractors included.

Keeping Appropriate Records that the Prevailing Wage Has Been Paid

In addition to ensuring that prevailing wages have been paid, taxpayers must keep appropriate records to prove these payments. To satisfy this recordkeeping requirement, the taxpayers must maintain books of account and records for all work performed by contractors or subcontractors. However, these records alone are not necessarily sufficient; the taxpayer must fundamentally maintain records proving the payment of prevailing wages to all relevant laborers and mechanics. As demonstrated in examples set forth in the Notice, this may include, but is not limited to, records that identify (1) the applicable wages determined for work performed, (2) the laborers or mechanics who performed CAR Work, (3) the classifications of work performed, (4) the hours worked in each classification, (5) the wage rates actually paid for the work, (6) wage rates determined by the Department of Labor, and (7) any and all correspondence with the Department of Labor, Wage and Hour Division, establishing prevailing wages not published on www.sam.gov.

Apprenticeship Requirements and How to Satisfy Them

The applicable statutory language in the IRA generally requires that a specific percentage of the labor hours for CAR Work on a qualified facility be performed by qualified apprentices. The applicable percentage depends on when construction of the facility begins, with that threshold percentage generally increasing with time. “Labor hours” means hours of work performed by laborers or mechanics. Like the prevailing wage requirements, the burden is on the taxpayer to ensure there is a sufficient amount of apprentice labor hours in the aggregate, including hours performed by laborers working for a contractor or subcontractor. Additionally, each taxpayer, contractor, or subcontractor who employs four or more individuals for CAR Work must also employ a minimum of one qualified apprentice.

A “qualified apprentice” is an individual that is both (1) employed or contracted by the taxpayer, a contractor, or a subcontractor, and (2) participates in a “registered apprenticeship program.” A registered apprenticeship program means any apprenticeship registered under the National Apprenticeship Act and which meets federal regulatory standards.

The minimum percentage of labor hours that must be performed by qualified apprentices is 12.5% for qualified facilities the construction of which begins before 1 January 2024, and 15% for qualified facilities the construction of which begins after 31 December 2023.

The above percentages, however, are subordinate to the apprentice-to-journeyworker ratios published by the Department of Labor and the applicable state apprenticeship agency. These ratios place a maximum limit on the amount of apprentices at any one job site. If a ratio is lower than the aforementioned applicable percentage prescribed by the IRA, then the taxpayer must ensure that the percentage of labor hours performed by qualified apprentices is commensurate with the applicable Department of Labor or state apprenticeship published ratios, rather than those prescribed by the IRA. That said, the requirement that a person that employs or contracts with four or more laborers must at least employ or contract a minimum of one apprentice applies regardless of the applicable required percentage of labor hours that must be performed by qualified apprentices.

Good Faith Exception

Regardless of the percentage of labor hours performed by qualified apprentices, the statutory language provides for a good faith exception, which deems the apprenticeship requirements are satisfied if the taxpayer requests qualified apprentices from a registered apprenticeship program, and either:

1. That request is denied for reasons other than refusal to comply with the standards and requirements of the apprenticeship program, or
2. The apprenticeship program fails to respond within five business days after the date it receives the request.

When Construction of a Qualified Facility Begins

For purposes of determining whether a project is deemed to have satisfied the "prevailing wage" and "apprenticeship" requirements, the Notice adopts beginning of construction rules that largely track those of prior notices, which were issued at a time when beginning of construction was relevant to determine the amount of the tax credit for which a project would qualify when certain tax credits were subject to phase-out over time. A taxpayer can demonstrate that the construction of a facility has begun in one of two manners: (1) by satisfying a "physical work test." or (2) by satisfying the requirements of the "five percent safe harbor."

A taxpayer satisfies the physical work test when physical work of a significant nature begins, and the taxpayer maintains a "continuous program of construction." The focus of this test is the nature of the work performed, with no fixed minimum labor hours or monetary expenditures required. Physical work includes work performed by third parties under a binding written contract entered into prior to the manufacture, construction, or production of property for use by the taxpayer in the taxpayer's trade or business. Physical work does not include preliminary activities like planning, designing, financing, exploring, researching, obtaining permits, licensing, surveying, performing environmental or engineering studies, or clearing the site even when the cost of such activities can be included in the depreciable basis of the facility. It also does not include work to produce property that is either in existing inventory or is normally held in inventory by a vendor.

A taxpayer satisfies the five percent safe harbor when the taxpayer pays or incurs five percent or more of the total cost of the facility, and the taxpayer makes "continuous efforts" to advance toward the completion thereof. All costs properly included in the depreciable basis of the facility count toward the total cost under this test. Costs incurred by a person under a binding written contract with the taxpayer count for the test if those costs relate to the manufacture, construction, or production of property for the taxpayer.

Both the "physical work test" and the "five percent safe harbor" include a "continuity requirement." Satisfaction of this requirement is dependent on the applicable facts and circumstances.

However, the IRS has provided a "continuity safe harbor" whereby the continuity requirement is deemed to be automatically satisfied. The safe harbor applies to certain qualified facilities placed in service within a certain time following the year in which construction is deemed to have begun, depending on the tax credit. The pertinent timeframes are:

- Facilities qualifying for credits under sections 30C, 45, 45V, 45Y, 48, and 48E — No later than four calendar years after the calendar year in which construction begins. The safe-harbor period increases to ten calendar years for certain offshore projects and projects built on federal land.
- Facilities qualifying for credits under section 45Q — No later than six calendar years after the calendar year in which construction begins.

Notice Leaves Several Issues Unanswered

The additional guidance provided by the Notice seems to be somewhat scant. Taxpayers are essentially directed to a database that provides applicable prevailing wages for certain types of work based on location and are directed to keep appropriate records to demonstrate the payment of these prevailing wages. The Notice provides some relief in the event the required minimum percentage of labor hours that must be performed by qualified apprentices would conflict with limits imposed by other labor requirements that are mandated at the federal or state levels. However, several questions remain unanswered. For example, the notice does not discuss the requirements for curing a failure to pay prevailing wages discovered post-hoc. It does not provide sufficient detail to help distinguish CAR Work, to which the “prevailing wage” and “apprenticeship” requirements apply, from routine operations and maintenance work at the applicable facility. Further, it is unclear what type of documentation should be kept to demonstrate that the good faith exception to the “apprenticeship” requirement applies.

It seems that Treasury and the IRS have somewhat rushed the issuance of the Notice less than 30 days after the deadline for the submission of requested comments in order to begin the 60-day clock, so that projects whose construction begins after that clock runs out have to actually satisfy the “prevailing wage” and “apprenticeship” requirements in fact. While it is understandable from a policy perspective that the administration wants the enhanced labor requirements for these incentives to apply as soon as possible, it remains to be seen whether the guidance issued in the Notice will be sufficient for a smooth administration of these requirements or whether subsequent guidance will need to be issued to address a number of remaining areas of uncertainty.

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