Congress Extends and Expands Tax Credit for Electric Vehicles

December 5, 2022

The Inflation Reduction Act (the "IRA"), which became law in August 2022, provides one of the most significant packages of renewable energy incentives in recent history. Most of the renewable energy provisions take the form of extended and expanded tax credits, which apply to investments in solar, wind, geothermal and other nontraditional energy resources. One tax credit provision of the IRA that will be of interest to ordinary consumers are the changes to the tax credit for taxpayers who purchase an electric vehicle (the "EV tax credit").

The EV tax credit provision of the IRA extends and expands the availability of the old EV tax credit. At the same time, the IRA introduced several provisions that limit the EV tax credit to lower income taxpayers and lower priced vehicles. The most significant changes to the EV tax credit in the IRA include the following:

- The IRA extends the availability of the EV tax credit until December 31, 2032.
- The IRA made several changes to the requirements for an electric vehicle to qualify for the EV tax credit, including (i) an increase in the minimum capacity of the battery from 4 kilowatt hours to 7 kilowatt hours and (ii) a new reporting requirement that the seller of the vehicle must provide certain information about the sale to the IRS and the purchaser.
- The IRA imposed new "critical materials" and "battery component" requirements for an electric vehicle to qualify for the tax credit. Under these requirements, a substantial amount of the raw materials and manufactured components of an electric vehicle's battery must be produced in North America in order to qualify for the EV tax credit.
- The IRA eliminated the phase-out in the old rules that limited the EV tax credit if the relevant manufacturer produced 200,000 or more electric vehicles.
- The IRA provides a new EV tax credit for the purchaser of used electric vehicles.
- Under the IRA, the EV tax credit is phased out for taxpayers whose modified adjusted gross income exceeds certain thresholds and for certain vehicles if the manufacturer's suggested retail price exceeds certain thresholds.

The remainder of the memorandum provides an overview of the EV tax credit provisions as amended by the IRA.

General Requirements

The IRA's changes to the EV tax credit are generally effective as of January 1, 2023, and are available for vehicles placed into service up until December 31, 2032. In order to qualify for the revised EV tax credit, a vehicle must be a "new clean vehicle." The amount of the EV tax credit is $3,750 if the vehicle meets the critical materials requirement or the battery component requirement, described below, and $7,500 if it meets both requirements.

Definition of New Clean Vehicle

For the purposes of the EV tax credit, a "new clean vehicle" is a motor vehicle[1] that meets the following requirements:

- The original use of the vehicle must commence with the taxpayer.
- The taxpayer must acquire the vehicle for use or lease (and not for resale).

- The vehicle must be made by a “qualified manufacturer,” which generally is a manufacturer that enters into a special agreement with the IRS to provide vehicle identification numbers and certain other information to the IRS.
- The vehicle must be treated as a “motor vehicle” for purposes of Title II of the Clean Air Act.
- The vehicle must have a gross vehicle weight rating of less than 14,000 pounds.
- The vehicle must be propelled to a significant extent by an electric motor which draws electricity from a battery which (i) has a capacity of not less than 7 kilowatt hours, and (ii) is capable of being recharged from an external source of electricity.
- The “final assembly” of the vehicle must occur within North America. For the purpose of this requirement, final assembly means the process by which a manufacturer produces a new clean vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle.
- The seller of the vehicle must furnish a report providing certain information about the sale to the taxpayer and to the IRS. This report must include the taxpayer’s name and taxpayer identification number, the vehicle’s VIN, the battery capacity of the vehicle, verification that the taxpayer is the original purchaser, the maximum EV tax credit allowable for the vehicle, and, in some cases, certain other information.

The revised EV tax credit provides that a new clean vehicle includes certain fuel cell motor vehicles if the final assembly of the vehicle occurs within North America and the seller meets the reporting requirements referred to in H, above.

Amount of EV Tax Credit

The amount of the EV tax credit is determined by whether the vehicle meets a critical materials requirement and/or a battery component requirement. The vehicle qualifies for a $3,750 credit for each of these requirements that it meets. If the vehicle meets both requirements, it qualifies for a total EV tax credit of $7,500.

The critical materials requirement is met if at least a specified percentage of the value of the “applicable critical materials”[2] contained in the battery either (i) is extracted or processed in the United States or a country with which the United States has a free trade agreement or (ii) is recycled in North America. For this purpose, the specified percentage of critical materials that must meet this requirement phases in over time on the following schedule:

- 40% for 2023
- 50% for 2024
- 60% for 2025
- 70% for 2026
- 80% for 2027 through 2032

The battery component requirement is met if at least a specified percentage of the value of the components contained in the battery is manufactured or assembled in North America. Like the critical materials requirement, the specified percentage for the battery component requirement phases in over time on the following schedule:

- 50% for 2023
- 60% for 2024 and 2025
- 70% for 2026
- 80% for 2027
- 90% for 2028
- 100% for 2029 through 2032

Limitations

Several limitations apply to vehicles intended to qualify for the EV tax credit. For example, the EV tax credit is generally not available with respect to a vehicle used predominantly outside the United States or for a vehicle that does not comply with the Clean Air Act (or applicable state air quality laws) or certain other motor vehicle safety laws.

The IRA introduced the following new limitations on the availability of the EV tax credit:

- A taxpayer cannot qualify for the EV tax credit unless he or she includes the vehicle's VIN on the taxpayer's tax return for the relevant year.
- The EV tax credit phases out for taxpayers whose modified adjusted gross income for the current or previous taxable year is more than a threshold amount. The thresholds are $300,000 for a joint return, $225,000 for a head of household, and $150,000 for an individual taxpayer or a married taxpayer filing separately.
- A vehicle does not qualify for the EV tax credit if the manufacturer's suggested retail price exceeds specified thresholds. The thresholds are $80,000 for vans, SUVs, and pickup trucks, and $55,000 for other vehicles.

EV Tax Credit for Used Electric Vehicles

The IRA includes a new provision that allows a reduced EV tax credit for the purchaser of a used electric vehicle. The requirements for the used EV tax credit include the following:

- The amount of the used EV tax credit is 30% of the sales price for the vehicle, up to a maximum of $4,000.
- Similar to the EV tax credit for a new vehicle, the used EV tax credit is subject to a phase-out based on the taxpayer's modified adjusted gross income for the current or previous taxable year. The thresholds for the used EV tax credit are $150,000 for a joint return, $112,500 for a head of household, and $75,000 for an individual taxpayer or a married taxpayer filing separately.
- The vehicle must be two years old when purchased and the price cannot exceed $25,000.
- The used EV tax credit is only available for the first purchaser who buys the vehicle from the original owner.

Conclusion

The IRA generally expands access to the EV tax credit, although it also includes provisions meant to encourage manufacturers to produce electric vehicles and their batteries in North America and the United States in particular. At the same time, the IRA introduced measures to limit the availability of the EV tax credit for high-income taxpayers or luxury vehicles. Taxpayers who may be subject to the new limitations may want to purchase a new electric vehicle before the new rules become effective on January 1, 2023.

Some aspects of the new rules will benefit from additional guidance from the IRS. The IRA specifically directs the IRS to issue regulations to provide more detail on the critical materials and battery component requirements, as well as the classification of vehicles for the limitation on the EV tax credit based on the manufacturer's suggested retail price. It will be difficult to apply the revised EV tax credit until these new regulations are available. Chapman is monitoring the situation closely and will provide updates when new information is available.

For More Information

If you would like further information concerning the matters discussed in this article, please contact Heath Martin or the Chapman attorney with whom you regularly work:

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1 For this purpose, a motor vehicle is defined as any vehicle which is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails) and which has at least four wheels.

2 Applicable critical materials generally include aluminum, antimony, arsenic, barite, beryllium, bismuth, cerium, cesium, chromium, cobalt, dysprosium, erbium, europium, fluorspar, gadolinium, gallium, germanium, graphite, hafnium, holmium, indium, iridium, lanthanum, lithium, lutetium, magnesium, manganese, neodymium, nickel, niobium, palladium, platinum, praseodymium, rhodium, rubidium, ruthenium, samarium, scandium, tantalum, tellurium, terbium, thulium, tin, titanium, tungsten, vanadium, ytterbium, yttrium, zinc and zirconium. Some of these minerals only qualify as applicable critical materials if they meet a minimum purity requirement or other requirements provided in Section 45X(c)(6). References to “Sections” in this memorandum refer to sections of the Internal Revenue Code of 1986, as amended.