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## REPORT



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Victoria Prussen Spears

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# A Look at Foreign Entities of Concern and the Section 30D Clean Vehicle Tax Credit

*By Nicole M. Elliott, Mackenzie A. Zales, Amish Shah and Mary Kate Nicholson\**

*In this article, the authors summarize the statutory rules and highlight key features of the proposed guidance released recently by the U.S. Department of Energy defining “foreign entity of concern” under the Infrastructure Investment and Jobs Act.*

The U.S. Department of Energy (DOE) recently released proposed guidance defining “foreign entity of concern” (FEOC) under the Infrastructure Investment and Jobs Act (IIJA). Among other reasons, this proposed guidance is important because of relevance under Internal Revenue Code Section 30D, the Clean Vehicle Tax Credit. Simultaneously, the U.S. Department of the Treasury and IRS proposed guidance under Section 30D, referencing the DOE definition of FEOC and also clarifying the rules around their application in the context of the Clean Vehicle Tax Credit.

This article summarizes the statutory rules and highlights key features of the guidance issued.

## **BACKGROUND ON THE CLEAN VEHICLE TAX CREDIT AT SECTION 30D**

The Inflation Reduction Act of 2022 (IRA) greatly modified the existing Section 30D credit for consumers purchasing clean energy vehicles. Importantly, under such modifications, Section 30D would prohibit this tax credit under two circumstances:

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- “(A) any vehicle placed in service after December 31, 2024, with respect to which any of the applicable critical minerals contained in the battery of such vehicle (as described in subsection (e)(1)(A)) were extracted, processed, or recycled by a *foreign entity of concern* (as defined in section 40207(a)(5) of the Infrastructure Investment and Jobs Act (42 U.S.C. 18741(a)(5))) (“IIJA”);” or
- “(B) any vehicle placed in service after December 31, 2023, with respect to which any of the components contained in the battery of such vehicle (as described in subsection (e)(2)(A)) were manufactured or assembled by a *foreign entity of concern* (as so defined).”

The IIJA, in turn, creates four distinct criteria that would render a “foreign entity” a “foreign entity of concern.” Although three of the four criteria are clearly connected to positive lists (i.e., entities designated as terrorist organizations, entities included on the list of specially designated nationals and blocked persons, and entities alleged by the U.S. Attorney General to have been involved in activities for which a conviction was obtained under specific statutes), the final criteria<sup>1</sup> create a category of entities that, until the recent guidance, was ambiguous based on several terms that were undefined.

Specifically, Section 18741(a)(5)(C) states that an FEOC is “a foreign entity that is . . . owned by, controlled by, or subject to the jurisdiction or direction of a government of a foreign country that is a covered nation.”

## DOE GUIDANCE

Although the identify of which countries are considered a covered nation<sup>2</sup> is established clearly by statutory reference, the other terms required further clarification. The DOE provided such clarity recently when it issued proposed guidance.<sup>3</sup> The DOE’s guidance leverages other existing federal guidance to define FEOC but also provides some additional new rules in the context of the battery supply chain.

Specifically, to determine whether an FEOC exists, a two-step analysis is required.

### Step 1

Determine if there is a foreign entity. Under DOE guidance, a foreign entity is one that meets any of the following four criteria:

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<sup>1</sup> 42 U.S.C. § 18741(a)(5)(C).

<sup>2</sup> “Covered nation” includes the Democratic People’s Republic of North Korea, People’s Republic of China, Russian Federation and Islamic Republic of Iran.

<sup>3</sup> <https://www.federalregister.gov/documents/2023/12/04/2023-26513/section-30d-excluded-entities>.

1. A government of a foreign entity;
2. A natural person who is not a lawful permanent resident of the United States, citizen of the United States or any other protected individual (as such term is defined in 8 U.S.C. § 1324b(a)(3));
3. A partnership, association, corporation, organization or other combination of persons organized under the laws of or having its principal place of business in a foreign country; or
4. An entity organized under the laws of the United States that is owned, controlled by or subject to the direction of an entity qualifying as a foreign entity under categories 1-3.<sup>4</sup>

For most, the last two criteria will be most relevant to the analysis. Many will qualify as a foreign entity, but it is critical to continue to Step 2, as many foreign entities will not be considered FEOCs.

## Step 2

Determine if the foreign entity is an FEOC. Under DOE guidance, a foreign entity is an FEOC if either of the two below criteria is met:

1. The foreign entity is subject to the jurisdiction of a covered nation. This occurs when the foreign entity either:
  - a. Is incorporated or domiciled in, or has its principal place of business in, a covered nation; or
  - b. Engages in the extraction, processing or recycling of specific battery components, critical minerals or battery materials in a covered nation.
2. The foreign entity is owned by, controlled by or subject to the direction of a government of a foreign country that is a covered nation.<sup>5</sup> This occurs when either:
  - a. 25 percent or more of the foreign entity's board seats, voting rights or equity interests are cumulatively held<sup>6</sup> by the foreign

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<sup>4</sup> The definitions below, which discuss how DOE interprets "owned by, controlled, or subject to the direction of." In the context of U.S. entities, the same definitions apply but are used to determine status as a "foreign entity" rather than an FEOC.

<sup>5</sup> "Government of a foreign country that is a covered nation" is defined broadly and would include the national or subnational government, agencies or instrumentalities of the government, the dominant or ruling political party, and current or former senior foreign political figures.

<sup>6</sup> "Cumulatively held" requires consideration of the combined interests of all other entities that qualify as a foreign entity, including any entities that enter into a formal arrangement to act in concert.



government, whether directly or indirectly<sup>7</sup> via one or more intermediate entities; or

- b. As it relates to specific battery components, critical minerals or battery materials, the foreign entity has entered into a licensing arrangement or other contract with a contractor that is an FEOC that entitles the FEOC contractor to exercise effective control<sup>8</sup> over the extraction, processing, recycling, manufacturing or assembly of such items.

The 25 percent test rules require careful consideration along the corporate chain. The test is also disjunctive, i.e., requires consideration of board seats, voting rights and equity. There is also a special rule as it applies to subsidiaries of FEOCs, if the FEOC designation of the parent entity was determined because it is incorporated or domiciled in, or has its principal place of business in, a covered nation (i.e., criteria 1a above). In such cases, the subsidiary is not automatically an FEOC but rather is an FEOC only if it independently meets the criteria.

## TREASURY DEPARTMENT AND IRS GUIDANCE

On the same day the DOE-proposed regulations were released, the Treasury Department and the IRS released proposed regulations and Revenue Procedure 2023-38 that provides procedural rules for qualified manufacturers of new clean vehicles to comply with the reporting, certification and attestation requirements regarding the FEOC rules under Section 30D.

The proposed regulations reference the DOE rules on FEOC and state that FEOC determination is made at the time the activity (e.g., the extracting) takes place. The guidance creates rules for battery components (other than battery cells), applicable critical minerals, battery cells and batteries.

Although the statute does not refer to battery cells but rather to battery components and critical minerals, the proposed regulations account separately

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<sup>7</sup> Application of the indirect control rules differs depending on whether the parent entity holds 50 percent or more board seats, voting rights or equity interest, or less than 50 percent. Specifically, if a parent entity holds a 50 percent or greater interest in a subsidiary, then the parent assumes the full interest the subsidiary has in any of its subsidiaries, regardless of any potential dilution due to partial ownership. In contrast, if the parent entity of a subsidiary holds less than 50 percent interest, then control over any of the subsidiary's interests is measured in proportion to their interest.

<sup>8</sup> "Effective control" means the right of the FEOC contractor to determine the quantity or timing of production, to determine which entities may purchase or use the output of production, or to restrict access to the site of production to the contractor's own personnel; or the exclusive right to maintain, repair or operate equipment that is critical to production.

for battery cells, given that they contain both battery components and critical minerals (and their associated constituent materials). Battery cells are treated as FEOC-compliant by looking separately at the battery components they contain and the critical minerals they contain.

For vehicles placed in service after December 31, 2023, the battery must be FEOC-compliant to qualify for Section 30D. In 2024 and beyond, battery components (stand-alone and as contained in battery cells) cannot be assembled or manufactured by an FEOC. In 2025 and beyond, an additional consideration must be made – the critical materials (and the associated constituent materials) contained in battery cells cannot be extracted, processed or recycled by an FEOC.

Under these rules, the qualified manufacturer of the vehicle must make a determination as to whether battery components and critical minerals (and the associated constituent materials) are FEOC-compliant, track them to specific battery cells (as applicable in the case of battery components), and track battery components and battery cells into specific batteries.

However, there are two special, temporary rules proposed:

1. *Non-Traceable Materials*: These may be excluded from consideration by the qualified manufacturer, so long as the manufacturer demonstrates how it will comply once the transition rule is no longer in effect.
2. *Allocation of Critical Minerals (and their Associated Constituent Materials)*: The qualified manufacturer can make a determination that a battery cell is compliant as it relates to critical minerals based on an allocation methodology rather than tracking them to specific battery cells.

As expected, FEOC compliance will require a great deal of information gathering and tracking. The transition rules are limited through 2026.

The remainder of the proposed regulations discuss the processes by which a qualified manufacturer must determine whether the battery is FEOC-compliant. Importantly, while tracking is required to specific batteries, those batteries need not be tracked to specific vehicles.

Specifically, qualified manufacturers are required to maintain and update a “compliant-battery ledger” under which upfront review will be conducted by the IRS and DOE. A qualified manufacturer must demonstrate that it has sufficient FEOC-compliant batteries documented in the ledger to account for the number of vehicles it reports to the IRS as eligible for the credit. These rules are relaxed for vehicles placed in service in 2024; no compliant-battery ledger

must be reviewed, and while qualified manufactures must make certain attestations, no physical tracking to specific batteries or specific vehicles is required.

The creation of a compliant-battery ledger with upfront review by the government will certainly create additional compliance burdens on qualified manufacturers. At least in the short term, this new process will not be implemented.

## **CONCLUSION**

The proposed guidance discussed above has great import to clean vehicle manufacturers and the supply chain that supports them. Among other things it will require manufacturers to know their supply chain well to ensure that they do not unknowingly run afoul of the rules by sourcing from an FEOC. The deadline to provide comments on the proposed guidance has passed; it will be finalized based on comments received and is therefore subject to change.