

AUTOMOTIVE INDUSTRY ALERT

June 9, 2023

MATTHEW LAPIN

202.778.3030

mlapin@porterwright.com

This law alert is intended to provide general information for clients or interested individuals and should not be relied upon as legal advice. It does not necessarily reflect the views of the firm as to any particular matter or those of its clients. Please consult an attorney for specific advice regarding your particular situation.

Please see our other publications at www.porterwright.com/media.

Risks and opportunities for manufacturers and suppliers in EV incentive programs

As incentives expand for U.S. purchase and production of electric vehicles, batteries and charging infrastructure, an increasingly complex set of regulatory requirements for consumers and industry has emerged. Tax credits and federal funding encourage EV investment, but that does not mean the industry is a free-for-all. In particular, manufacturers and their counsel should understand potential policy and legal issues related to U.S. content and sourcing requirements when making critical decisions regarding their supply chain and production siting.

The push to invest close to home

The largest incentive program is the consumer tax credit created by the Inflation Reduction Act (IRA) for purchasers of EVs where final assembly of battery components is in North America and critical minerals for battery production meet sourcing requirements. Vehicles meeting both criteria are eligible for a \$7,500 credit; those meeting one are eligible for a \$3,750 credit.

Critical minerals requirement

The consumer credit currently requires that 40% of an EV battery's critical minerals be extracted/processed in the U.S., or any country with which the U.S. has a free trade agreement, or recycled in North America, increasing 10% annually, up to 80% in 2026. Beginning in 2024, batteries containing critical minerals extracted, processed or recycled by "entities of concern" (those in or controlled by China, Russia, Iran, N. Korea, etc.) will not qualify. By 2025, no batteries with critical minerals sourced from these countries will be permitted under the incentive program.

There's considerable debate over eligibility requirements for critical minerals sourcing. Negotiations to cover the E.U. under free trade agreement requirements are ongoing, but even when that negotiation is finalized, fundamental issues may remain. Currently, most E.U. manufactured batteries contain critical minerals from China, meaning that permitting sourcing from the E.U. presents a policy challenge to domestic goals of reducing dependence on Chinese critical minerals. Also at issue is Department of Treasury's methodology for calculating critical mineral content after 2024. Manufacturers and suppliers will need to develop and implement systems to effectively track materials sourcing to meet these requirements, as well as the "no entity of concern" requirements. They will also want to ensure they effectively advocate before Treasury for rational future content requirement rules as new requirements are phased-in.

North America assembly requirement

Currently, the consumer credit requires that half of battery component value be produced in North America, increasing to 100% by 2029. Some key battery components are excluded from this requirement (instead subject to less restrictive critical mineral sourcing requirements noted above).

This limitation may be open to challenge by the E.U. and other countries under World Trade Organization rules, although efforts by the U.S. to negotiate with these countries may reduce the likelihood of such challenges. However, even if successfully negotiated, the assembly requirement risks an arms race of countries similarly incentivizing domestic production. This could have the contradictory effect of driving down production costs for domestically-produced and sold EVs but still ultimately limiting growth of the global EV industry. This would also further complicate manufacturer and supplier efforts to maintain compliance with multiple content requirement schemes and regularly monitor changes to any such competing domestic preference programs in the E.U. and other markets.

Commercial credits and funding

The IRA offers direct incentives to manufacturers through production tax credits (PTCs) for U.S. manufacture of cathode and anode materials in lithium-ion batteries and critical battery minerals. For U.S. manufactured items sold after Dec. 31, 2022, a 10% credit is available. This credit will phase out in 25% annual increments starting in 2030 and is unavailable for sales after 2032. Production of battery cells/modules in the U.S. are also eligible for PTCs, based on capacity in kilowatt hours of battery cells/modules. The credits are eligible for direct payment from Treasury and the right to the credit can be sold for cash to third parties (subject to limitations). Of potential importance is recent clarifying guidance from Treasury indicating that these tax credits are not subject to the sourcing restrictions related to China, Russia, etc.

The Federal government is also funding EV infrastructure, including over \$5 billion to date. As with the consumer tax credits and PTCs, recently issued standards for Federally funded EV infrastructure contain significant U.S. domestic content requirements for steel, iron, manufactured products and construction materials starting in July 2024.

Much like the consumer tax credits noted, manufacturers and suppliers will need to implement effective monitoring and compliance systems to track materials sourcing and component manufacturing.

Intersection with other policies and forecast

One of the greatest challenges for manufacturers and suppliers is that these EV incentives are highly susceptible to political risk. To the extent future administrations or legislatures take a different view regarding these incentive programs, manufacturers and suppliers would be advised to prepare for multiple contingencies—such as reduction in consumer tax credits or PTCs, more stringent content requirements, large decreases in funding of infrastructure—and regularly monitor regulatory and legislative developments. Other policy initiatives—e.g. environmental regulations, anti-forced labor restrictions impacting China—should also be taken into account by manufacturers and suppliers in their planning.

In summary, the combination of consumer and production tax credits and federal infrastructure funding has great potential to encourage investment in U.S. R&D and production of EVs, batteries and infrastructure; however these programs are vulnerable to both competing policy priorities and political risks. Manufacturers and suppliers looking to participate in these programs will want to invest in effective compliance programs and regulatory monitoring to ensure their sourcing and siting decisions are consistent with evolving requirements and any policy changes to maximize their benefit and minimize their risk.

For more information on EV-related federal programs, please contact [Matt Lapin](#) in Washington, D.C., or any member of Porter Wright's [Automotive & Mobility Emerging Technologies Practice Group](#).