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INSIGHT

Proposed Tax Preference for Domestic Content in Energy Infrastructure

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The Inflation Reduction Act of 2022 (IRA), now pending in Congress, would substantially revise numerous tax credits designed to support investment in energy infrastructure. Companies building wind farms, geothermal power generation, and a range of other energy-related projects could receive an additional, or bonus, tax credit if the project incorporates domestically sourced iron, steel, and manufactured components. This would mark an expansion of domestic preference policies, which currently apply to various forms of federal financial assistance but are not a part of any tax preferences.

Overview of Domestic Preference Requirements

Federal domestic preference laws seek to support U.S. manufacturing by requiring use of U.S.-made products in certain situations. The Buy American Act, the Berry Amendment, and several other laws require that some goods purchased directly by the federal government be manufactured domestically. Separately, several statutes and regulations collectively known as Buy America require that states, municipalities, and other recipients of federal grants for transportation and infrastructure ensure that domestic goods are used in their projects. Buy America covers public works such as highways, transit lines, and water and sewage construction; it also requires, for example, that passenger rail cars purchased by Amtrak be assembled in the United States.

The Infrastructure Investment and Jobs Act (IIJA; P.L. 117-58), enacted November 15, 2021, expanded Buy America coverage to other types of infrastructure projects funded by federal grants, such as electric power transmission facilities and broadband infrastructure. The law also broadened the types of manufactured goods covered by Buy America to include nonferrous metals, such as copper used in electric wiring; plastic- and polymer-based products; glass, including optical fiber; and construction materials, such as lumber and drywall. To be considered "produced in the United States" under the IIJA, manufactured goods other than iron and steel must contain greater than 55% domestic content.

These various laws, as well as laws requiring domestic production of military goods, all involve procurement funded directly or indirectly by federal money. The domestic preference provisions in the IRA, in contrast, would apply to entities claiming federal tax credits, creating an incentive for use of domestic manufactured goods rather than a requirement.

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Proposed Domestic Preference Provisions in Energy Tax Credits

The IRA proposes modifying and extending the energy production tax credit (PTC) and investment tax credit (ITC), which historically have supported investment in wind, solar, and other renewable energy infrastructure projects. After 2024, these tax credits would be replaced with technology-neutral clean electricity tax credits, designed to phase out as electric power sector emissions reduction targets are achieved.

The PTC is a tax credit for every kilowatt hour (kWh) of electricity produced at a qualifying renewable energy facility and sold during its first 10 years in operation. The IRA generally would extend the PTC at 2021 amounts, but only for projects that pay prevailing wages and meet registered apprenticeship or workforce requirements. (The maximum 2021 PTC rate was 2.5 cents per kWh, although not all technologies qualified for the maximum rate.) As proposed in the IRA, projects above a certain size threshold that do not meet the wage and workforce requirements (and begin construction after guidance is published on these new requirements) could qualify for credits that are 20% of the current-law statutory amount. Under the IRA, taxpayers claiming the PTC who meet the domestic content requirements could receive a bonus of 10% of the credit amount.

The ITC is a tax credit for investments in qualifying energy property. Under the IRA, the ITC for most types of renewable energy facilities would be 6% of the property's cost, or 30% if the project meets wage and registered apprenticeship requirements. The domestic content bonus credit amount would be 2 percentage points, or 10 percentage points if wage and workforce requirements are met.

To qualify for the PTC or ITC domestic content bonus credit, taxpayers would be required to certify that the iron, steel, and manufactured products that are components of power generating facilities were produced domestically. The bonus credit would apply starting in 2023, which could occur before the Treasury Department issues guidance, possibly contributing to uncertainty for taxpayers claiming tax credits based on domestic content. One question that may be addressed in future guidance is how Treasury might verify that the domestic content requirement thresholds for bonus credits have been met.

The IRA would require the iron and steel requirements be applied in a manner consistent with the Federal Transit Administration's Buy America regulations, which specify that all iron and steel manufacturing processes must take place in the United States. Manufactured products would be deemed domestically produced so long as a threshold percentage of the total costs of manufactured products (including components) in a facility are mined, produced, or manufactured in the United States. This percentage would be 40% (or 20% in the case of offshore wind projects) for projects beginning construction before 2025, rising in steps to 55% after 2026. There would be a slower increase in the percentage for offshore wind projects.

The IRA also would allow certain tax-exempt entities, including state and local governments and electric cooperatives, to receive tax credits as "direct pay," meaning that qualifying entities receive a payment from Treasury in lieu of claiming a tax credit—but only, for facilities above a certain size threshold, if the energy facility's construction meets domestic content requirements. The direct pay amount in 2024 would be 90% of the otherwise allowable amount for facilities not meeting the domestic content requirements. In 2025, for tax-exempt entities not meeting the domestic content requirements and claiming the new clean electricity credits as direct pay, the direct pay amount would be limited to 85% of the otherwise allowed amount. After 2025, direct pay would not be allowed for any facility not meeting the domestic content requirements.

The IRA would allow waivers of domestic preference requirements as a condition for receiving tax benefits as direct pay either when domestic products would increase the overall cost of the facility by more than 25% or when satisfactory domestic products are not available. These exceptions are common in existing domestic preference laws.

Author Information

Christopher D. Watson
Analyst in Industrial Organization and Business

Molly F. Sherlock
Specialist in Public Finance

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