



To: NHA Deep Dive Policy Team

From: Michael Purdie, Director of Regulatory Affairs and Markets

Date: June 30, 2023

Subject: Feedback Needed for Recommendations to Treasury with respect to Defining the Domestic Content of U.S. Hydropower Manufactured Products

On May 12, Treasury/IRS released [Notice 2022-38](#) – Domestic Content Bonus Credit Guidance. As a result of the Inflation Reduction Act, this credit provides a 10% adder to the Production Tax Credit (e.g., from 3 cents/kWh to 3.3 cents/kWh) or 10 percentage point adder to the Investment Tax Credit (e.g., from 30% to 40%). A taxpayer could increase their credit base from a small amount (i.e., 6% in the ITC) to a higher value (i.e., 30% for the ITC) if they pay prevailing wages and utilizes apprenticeships. They could increase their credit base further if they meet the requirements of the domestic content bonus credit.

Immediately after releasing the Notice, senior staff at the Treasury reached out directly to NHA because they recognized they did not incorporate our unique fact patterns and hydropower was not included in Table 2. Therefore, it is incumbent on the industry to provide useful recommendations, otherwise Treasury may adopt unworkable approaches. Also, NHA needs to engage to retain its credibility for future advocacy (e.g., 80/20 rule applicability to hydropower).

NHA is meeting with Treasury/IRS on July 20<sup>th</sup> to provide input and education on the unique fact patterns for hydropower that they need to address in modifying the guidance that could become the regulations for these tax credits.

NHA has identified three specific issues and is seeking feedback on each, but emphasis on member feedback for items 2 and 3 in particular:

- 1) The guidance requires a taxpayer (i.e., the project owner applying for the tax credit) to certify direct labor and materials costs paid or incurred by the *manufacturer(s)* in the production of manufactured components. This nuance will flow to the manufacturers and require that they certify the values they provide comply with the IRS regulations on the topic. This reading will subject U.S. manufacturers (who would not receive the bonus credit) to legal and financial risks. In addition, it creates significant administrative burden on the taxpayer to certify a credit based on internal, and potentially confidential, costs of a third party.

NHA's recommended path forward is for Treasury/IRS to modify the guidance where the calculation is based off the *price* the taxpayer incurs for manufactured components.

This concept is consistent with the tax code and Federal Transit Administration's (FTA) Buy America regulations which are referenced elsewhere in the Inflation Reduction Act and Notice 2023-38. NHA's recommended path forward is also consistent with the views of other technologies eligible for credits under the Inflation Reduction Act.

- 2) To qualify for the Domestic Content Bonus, the taxpayer must achieve a "Domestic Cost Percentage" of US manufactured products meeting or exceeding the applicable 40-55% requirement for their project. The Domestic Cost Percentage is the ratio of the cost of all US manufactured products versus all manufactured products.

Several different approaches have been suggested by NHA members. The underlying question is, what level of onsite direct labor and materials costs can be included in the domestic price calculation?<sup>1</sup>

- a. One approach is a bright-line test that would require all manufacturing to occur offsite (presumably beyond the FERC boundary) for the purposes of manufactured components. Any work that is onsite would be considered construction and/or assembly. This delineation keeps site work separate and distinct from the manufacturing of components that occurs in offsite shops.
- b. A second approach would delineate a set of activities that qualify as manufacturing whether they take place at a factory or on-site at the hydropower facility (due to transportation or other issues). This approach rests on an interpretation of FTA Buy America regulations as defined in 49 CFR 661.<sup>2</sup> The Manufacturing Process in this case means:

...the application of processes to alter the form or function of materials or of elements of the product in a manner adding value and transforming those materials or elements so that they represent a new end product functionally different from that which would result from mere assembly of the elements or materials.<sup>3</sup>

The FTA provides the following examples comprising manufacturing processes:

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<sup>1</sup> To qualify for the credit, the Applicable Project Component utilizing the Manufactured Product requirement must have costs of domestic sourced products as percentage of Applicable Project Components be greater than the Applicable Percentage (i.e., 40% for construction starting in 2023 rising to 55% for construction starting in 2026). This is separate from the Applicable Project Components utilizing the Steel and Iron Requirement.

<sup>2</sup> A component may be manufactured at the final assembly location if the manufacturing process to produce the component is an activity separate and distinct from the final assembly of the end product. 49 CFR 661.11(d).

<sup>3</sup> 49 CFR 661.3

“The processes of alteration may include forming, extruding, material removal, welding, soldering, etching, plating, material deposition, pressing, permanent adhesive joining, shot blasting, brushing, grinding, lapping, finishing, vacuum impregnating, and, in electrical and electronic pneumatic, or mechanical products, the collection, interconnection, and testing of various elements.” Final Rule, Buy America Requirements, 56 Fed. Reg. 926, 929 (Jan. 9, 1991).

Based on this interpretation, onsite construction would not be considered manufacturing. Consistent with the FTA Buy America Rules, onsite manufacturing would be considered eligible work if it can't occur at the project construction site but for the manufacturing process that is separate and distinct from assembling of the end product.

- c. A third, hybrid approach would recognize on-site activities as manufacturing if they meet the existing FTA federal definitions and relate to the process of putting the Prime Mover components together for a final product (e.g., as opposed to assembly and construction activities performed by a general contractor). This approach would recognize the different roles played by manufacturers and construction companies onsite.
- 3) The final issue results from Treasury/IRS creating two levels of components (i.e., Applicable Project Component and Manufactured Product Component). By creating a new definition, “Manufactured Product Component<sup>4</sup>,” that is in some form subordinate to “Applicable Project Components”<sup>5</sup> (that is defined in 49 CFR 661.3 under “Component”), Treasury/IRS is asking the taxpayer to certify the origin of their Manufactured Product Components. The Domestic Content Bonus explicitly allows for foreign sourced subcomponents to be used in Manufactured Product Components so long as the manufacturing process for the Manufactured Product Component takes place in the United States.
- a. The IRS and Treasury have published some specific “Safe Harbors” for wind, solar and battery projects in Table 2 of the draft guidance (see appendix). This will allow taxpayers for these projects to clearly understand the applicability of the domestic content guidance to typical elements of those project scopes. No

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<sup>4</sup> A Manufactured Component refers to anything that contributes to an Applicable Project Component that is a Manufactured Product. This can include both manufactured and unmanufactured items.

<sup>5</sup> An Applicable Project Component refers to anything that contributes to an Applicable Project. This can include steel, iron, a Manufactured Product, and more.

such information has been provided for hydropower or pumped storage hydropower projects.

- i. NHA staff requests member assistance on the inputs to Table 2.

NHA appreciates the differing views on how this guidance could be utilized for the benefit of the hydropower industry. Please reach out to NHA staff for questions and clarification.

# Appendix

## Table 2 from Notice 2023-38

### Table 2 – Categorization of Applicable Project Components

Applicable Project	Applicable Project Component	Categorization
Utility-scale photovoltaic system	Steel photovoltaic module racking	Steel/Iron
	Pile or ground screw	Steel/Iron
	Steel or iron rebar in foundation (e.g., concrete pad)	Steel/Iron
	Photovoltaic tracker	Manufactured Product
	Photovoltaic module (which includes the following Manufactured Product Components, if applicable: photovoltaic cells, mounting frame or backrail, glass, encapsulant, backsheet, junction box (including pigtailed and connectors), edge seals, pottants, adhesives, bus ribbons, and bypass diodes)	Manufactured Product
	Inverter	Manufactured Product
Land-based wind facility	Tower	Steel/Iron
	Steel or iron rebar in foundation (e.g., spread footing)	Steel/Iron
	Wind turbine (which includes the following Manufactured Product Components, if applicable: the nacelle, blades, rotor hub, and power converter)	Manufactured Product
	Wind tower flanges	Manufactured Product
Offshore wind facility	Tower	Steel/Iron
	Jacket foundation	Steel/Iron
	Wind tower flanges	Manufactured Product
	Wind turbine (which includes the following Manufactured Product Components, if applicable: the nacelle, blades, rotor hub, and power converter)	Manufactured Product
	Transition piece	Manufactured Product
	Monopile	Manufactured Product
	Inter-array cable	Manufactured Product
	Offshore substation	Manufactured Product
	Export cable	Manufactured Product

Battery energy storage technology	Steel or iron rebar in foundation (e.g., concrete pad)	Steel/Iron
	Battery pack (which includes the following Manufactured Product Components, if applicable: cells, packaging, thermal management system, and battery management system)	Manufactured Product