PROANALYSIS

WHAT YOU NEED TO KNOW ABOUT

# Policy Changes to EVs in the Inflation Reduction Act

BY TANYA SNYDER AND MADI ALEXANDER | 03/10/2023 05:00:00 AM EST

## PRO POINTS

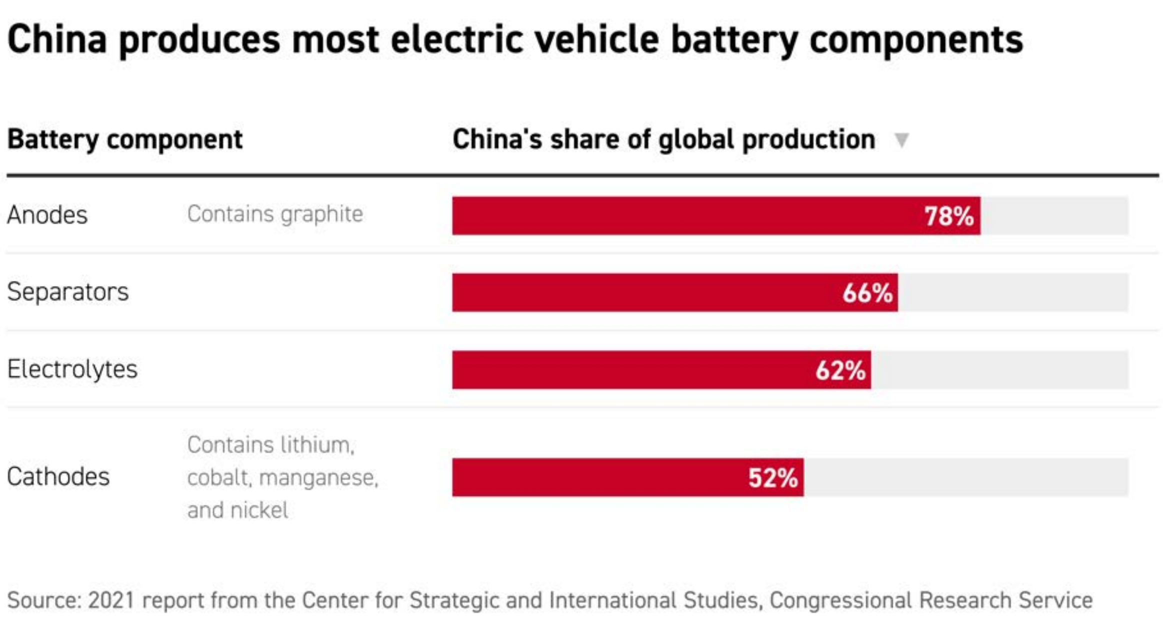
- **The Inflation Reduction Act, enacted in Aug. 2022, imposed major new restrictions on consumer tax** credits for purchasing an electric vehicle, which could all but disappear in 2023 — at least for a while.
- **To qualify for the tax credit, a vehicle's cost will have to be under a certain threshold, and its** batteries will have to be made up of components and minerals sourced from the United States or its free trade partners — and not China, which currently dominates EV battery production.
- **The changes come as the Biden administration is spending enormous resources to decarbonize** transportation, with a major focus on electric vehicles, including a huge federal investment in building charging stations.

## HOW WE GOT HERE

The tax credit for electric vehicle purchases that was in place before August 2022 was limited. Once 200,000 electric vehicles were sold across the country, cars made by that manufacturer no longer qualified for the $7,500 credit. Plus, the credit wasn't available for used cars. But Democrats' push to expand the tax credit in their 2022 climate bill, the Inflation Reduction Act, ran into opposition from one of their own: West Virginia Sen. Joe Manchin.

Manchin argued that the U.S. was trading being dependent on Saudi Arabia for being dependent on China, which dominates the production and refining of most of the minerals needed for electric vehicle batteries.

"We're going to be absolutely so taken advantage of, to the point where we're going to be held hostage by the foreign supply chain that China has a grip on," Manchin said, pledging, "I'm going to do everything I can to stop it."




What eventually emerged from negotiations between Manchin and Senate Majority Leader Chuck Schumer was a compromise: The tax credit would go forward — without the per-manufacturer cap — but with strict requirements on where the battery components and minerals are sourced.

The new tax credit:
— Offers a $7,500 tax credit if the battery components were made in North America and the vehicle's critical minerals were recycled in the U.

S. or mined in a
country that has a free trade agreement with the U.S.
— Reduces tax credit to $3,750 if the vehicle meets either the critical mineral or battery content requirement, but not both
— Eliminates the 200,000-vehicle cap per manufacturer
— Implements an income cap of $150,000 for individual filers and $300,000 for married filing jointly
— Excludes vehicles with battery content or critical minerals from foreign entities of concern, namely China
— Caps the eligible purchase price at $80,000 for vans, SUVs and trucks and $55,000 for all others
— Eliminates tax credit for vehicles assembled outside of North America

| ADDITIONAL CLEAN VEHICLE PROVISIONS | 2023 | '24 | '25 | '26 | '27 | '28 | '29 | '30 | '31 | '32 |
|---|---|---|---|---|---|---|---|---|---|---|
| Tax credit as a rebate at the point of sale | | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| Critical mineral requirement, as a percent of vehicle value | 40% | 50% | 60% | 70% | 80% | 80% | 80% | 80% | 80% | 80% |
| Critical mineral foreign entities of concern rule | | | ● | ● | ● | ● | ● | ● | ● | ● |
| Battery component requirement, as a percent of vehicle value | 50% | 60% | 60% | 70% | 80% | 90% | 100% | 100% | 100% | 100% |
| Battery component foreign entities of concern rule | | ● | ● | ● | ● | ● | ● | ● | ● | ● |

Sources: Congressional Research Service, Senate Finance Committee

Automakers immediately started protesting. Rather than expand the tax credit to accelerate the adoption of cleaner energy vehicles, they said, the new credit would shrink it and likely eliminate it altogether, at least for a while. The pace of opening new factories for building EVs and batteries in the United States has picked up dramatically since the law was enacted, with automakers and their suppliers racing to onshore the supply chain to comply with the law and be eligible for the tax credit.

But manufacturers also warn that even finding out the origin of every mineral in every piece of metal in every component of their batteries will take time, much less changing their supply chains to comply with the law.

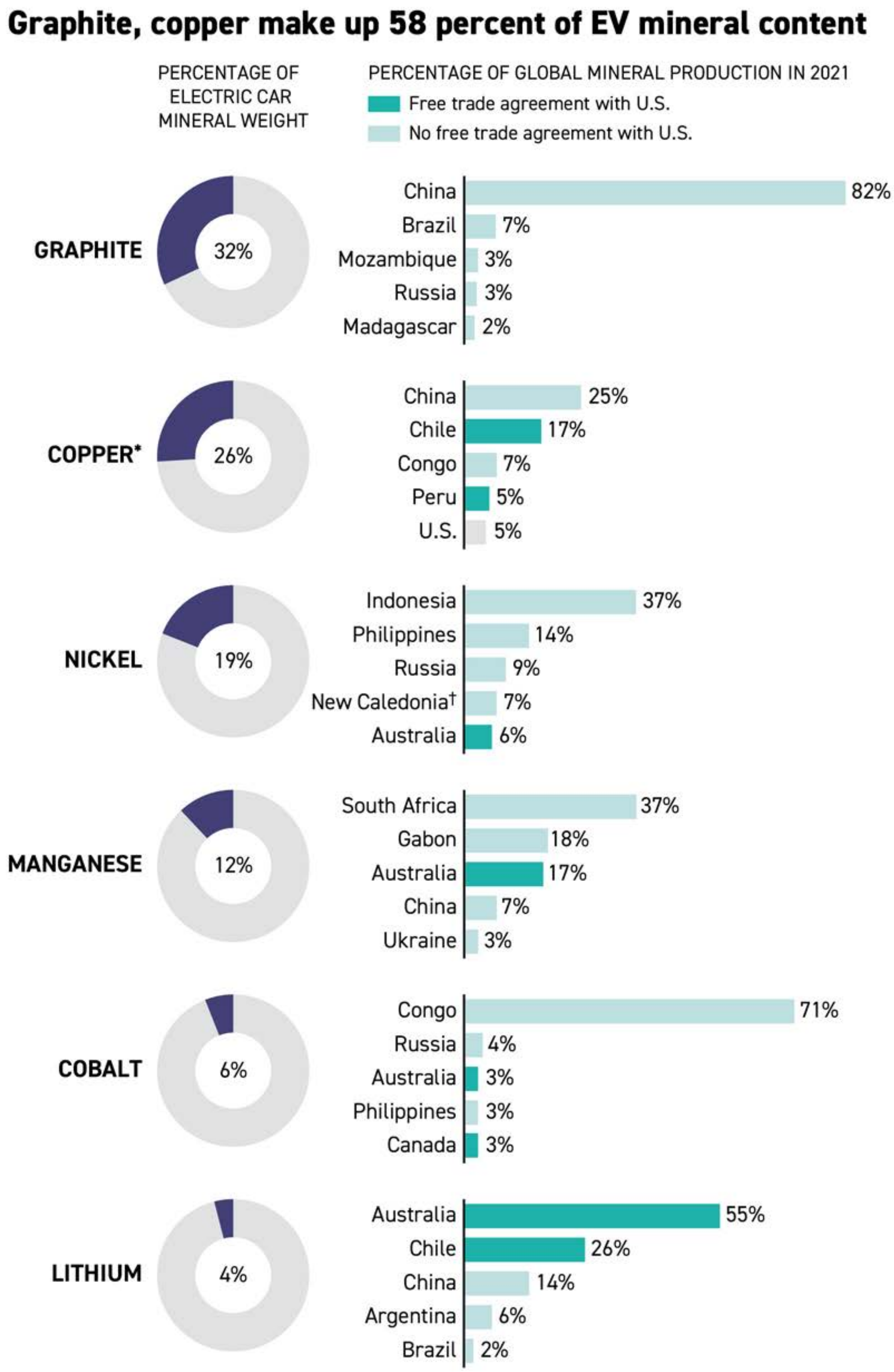
The Inflation Reduction Act also included major tax incentives for clean energy manufacturers — and in another nod to Manchin, $4 billion is earmarked for former coal communities, in order to ease the transition to a clean energy economy.

## WHAT'S NEXT

The Treasury Department is expected to release final guidance in March 2023 about how it will interpret the new restrictions. In initial guidance published in Dec. 2022, the department announced that the new sourcing requirements wouldn't take effect until the final guidance is published. Manchin was furious and tried unsuccessfully to force the restrictions into effect — with or without final rules from Treasury.

Manufacturers are eager to see how Treasury defines what is and is not a battery component, and what countries are on the list of acceptable sources for critical minerals and components.

The United States has free trade agreements with 20 countries, including Australia, home to the world's largest hard-rock lithium mine. But China still controls the processing and production of lithium from Australia and most of the rest of the world. And the tax credit, as written, is even stricter for components and minerals coming from "foreign entities of concern" such as China — starting in 2024 for components and 2025 for minerals, the only allowable percentage from China is zero.




*Includes mine and refinery production

†New Caledonia is a French territory.

Sources: International Energy Agency, United States Geological Survey

The vast majority of vehicles are likely to lose their eligibility for half, if not all, of the $7,500 consumer tax credit once Treasury publishes the rules and the consumer tax credit goes into effect.

Even the temporary disappearance or reduction in the tax credit sends a mixed signal from an administration that has thrown itself behind the task of transitioning transportation from gas to electricity. President Joe Biden has set a goal of EVs making up 50 percent of new vehicle sales by 2030 that would be ambitious even without this added roadblock. The tax credit is meant to bring the cost of EVs down to that of similar gas-powered vehicles to accelerate adoption — at the same time the federal government is spending $7.5 billion to build new charging stations, incentivizing the production of clean energy and transitioning to buying only electric vehicles for the federal government..

Still, advocates are hopeful that in the long term, having firmer control over the U.S. energy supply and its supply chain will only be beneficial for the country and the auto industry.

## POWER PLAYERS

- **Treasury Secretary Janet Yellen:** Treasury's initial guidance was written as broadly and leniently as possible in order to allow the greatest possible number of EVs to qualify for the tax credit. It remains to be seen what the final guidance will look like.

- **Sen. Joe Manchin:** The West Virginia Democrat flexed every bit of the muscle he had in the last Congress as the Democrats' must-please member to pass legislation. He was committed to making sure the Inflation Reduction Act strengthened U.S. energy security and manufacturing.

- **Albert Gore:** The former vice president's son is now the executive director of the Zero Emission Transportation Association, a trade group advocating for policies — like a broadly written tax credit — that will foster greater adoption of EVs.

- **Energy Secretary Jennifer Granholm:** The former governor of Michigan has been criss-crossing the country announcing new loans for battery production and recycling, in a role that has her working closely with Transportation Secretary Pete Buttigieg.