

CAPITOL TAX P A R T N E R S

Discussion of significant provisions in the proposed Treasury regulations implementing the labor requirements of the Inflation Reduction Act of 2022

Background

On August 29, 2023, Treasury and the IRS issued proposed regulations under the various Internal Revenue Code (Code) sections that, pursuant to the Inflation Reduction Act of 2022 (IRA), contain certain labor requirements that taxpayers must satisfy to increase the benefit of the tax benefits provided by these sections by a factor of five.¹ The labor requirements involve (1) the payment of prevailing wages to workers involved in the construction, alteration, and repair of qualified energy facilities, and (2) the use of a certain number of registered apprentices in the construction of the facilities.² The applicable Code sections are:

- section 30C (ITC for alternative fuel refueling property),
- section 45 (PTC for electricity from renewable sources),
- section 45L (new energy efficient home tax credit),
- section 45Q (PTC for carbon capture and sequestration),
- section 45U (PTC for nuclear power),
- section 45V (PTC for clean hydrogen),
- section 45Y (PTC for clean electricity),
- section 45Z (PTC for clean transportation fuel),
- section 48 (ITC for certain energy property),
- section 48C (ITC for advance energy projects),
- section 48E (ITC for clean electricity property), and
- section 179D (deduction for energy efficient commercial buildings).

The labor requirements apply to facilities the construction of which began more than 60 days after the publication of Treasury guidance with respect to the requirements. On November 30, 2022, Treasury and the IRS published Notice 2022-61, triggering this 60-day deadline (i.e., the labor requirements apply to construction beginning after January 28, 2023).³ The Notice did

¹ Satisfying the labor requirements results in the taxpayer being entitled to an “increased tax credit” for purposes of this document. The prevailing wage and apprenticeship requirements do not apply to (1) facilities with a maximum nameplate capacity of less than one megawatt or (2) facilities the construction of which began before January 29, 2023 (beginning of construction exception).

² Some of the applicable Code sections only mandate a prevailing wage requirement.

³ The labor requirements generally do not apply to facilities with a maximum net output of less than 1 megawatt, regardless of when construction began.

not provide a significant amount of substantive guidance, largely defaulting to and cross referencing various Department of Labor (DOL) rules. These proposed regulations clarify and amplify many of the rules of the Notice and provide needed guidance on aspects of the labor requirements not addressed in the Notice.

An overview of the proposed regulations prepared by Treasury and the IRS can be found at <https://www.irs.gov/pub/irs-pdf/p5855.pdf>. The purpose of this document is to provide a discussion of some of the more significant portions of the proposed regulations, with a focus on issues not addressed in the Notice. These include the “cure” provisions for the prevailing wage and apprenticeship requirements, the exceptions for the apprenticeship requirement, ways to avoid the base and increased penalties for initial noncompliance, and recordkeeping requirements.

These regulations generally are proposed to apply with respect to facilities, property, projects, or equipment (i) placed in service in taxable years ending after the date the final regulations are published, and (ii) for which the construction or installation began after such publication date. Taxpayers generally may rely upon the proposed regulations until 60 days after final regulations are published if the construction or installation of the facility, property, plant, or equipment commenced on or after January 29, 2023.

Prevailing wages

In general. - Section 45(b)(7)⁴ provides that laborers and mechanics (“workers”) employed by the taxpayer or any contractor or subcontractor in the construction of a facility (and for a period thereafter) must be paid wages at rates not less than the prevailing wage for the construction, alteration, or repair of a similar character in the locality in which the facility is located as determined by the DOL. The proposed regulations clarify aspects of this basic rule, including:

- The proposed regulations generally adopt DOL’s Davis-Bacon rules for wage determinations, and definitions of “contractors and subcontractors,” “laborers,” “mechanics,” “locality,” “construction, alteration, or repair,” “wages” and “employed.” For example, the definition of “construction, alteration or repair” does not borrow from the tax distinctions between capitalized and deductible expenditures, but generally includes most expenditures other than for maintenance. The proposed regulations define maintenance as “work designed to maintain and preserve functionality of a facility after it is placed in service, includes basic maintenance such as regular inspections of the facility, regular cleaning and janitorial work, replacing materials with limited lifespans such as filters and light bulbs, and the calibration of any equipment,”

⁴ Except as otherwise noted, this document will reference the proposed regulations under section 45, although similar rules are applicable to the other relevant Code sections with labor requirements.

but “does not include work that improves a facility, adapts it for a different use, or restores functionality as a result of inoperability.”

- The responsibility for ensuring that the prevailing wage requirements are met is on the taxpayer claiming the tax credit (or the transferor in the case of a tax credit transferred pursuant to section 6418) even though some of the workers will be independent contractors or employees under the supervision of a contractor or subcontractor. The responsibility begins at the start of construction.
- Prevailing wage rates generally would be determined pursuant to rates published by DOL for the types of job classifications in a geographic area as in effect when construction begins. Such rates generally would remain applicable for the term of the contract. The prevailing wage rate would need to be updated with respect to certain contract modifications (e.g., additional work not in the scope of the original contract) and any alteration or repair that begins after the facility is placed in service. If prevailing wage rate information is not available, taxpayers can request and receive a supplemental wage determination from the DOL. The proposed regulations describe the process for such requests.
- For offshore projects located within the outer continental shelf of the United States, taxpayers can use rates applicable to the geographic area closest to where the facility will be located.
- The proposed regulations address situations where a facility may encompass multiple localities or have secondary sites where significant work is performed.
- The proposed regulations provide that an apprentice may be paid less than the full prevailing wage rate consistent with DOL rules. The taxpayer must observe the apprenticeship ratio applicable to registered apprenticeship programs (described below) in determining the number of apprentices that may be paid at reduced rates.

“Cure” provisions. – Section 45(b)(7)(B)(i) provides that if the prevailing wage requirement is not met with respect to any worker, a taxpayer may cure the defect by paying the worker any shortfall in wages plus interest. A penalty of \$5,000 per worker, payable to the IRS, also applies. If the failure to pay the prevailing wage is as a result of intentional disregard of the requirement, the amount due to the worker is tripled and the penalty is doubled.

The proposed regulations provide rules regarding the payment of any wage shortfall and penalties. Under the proposed regulations, the prevailing wage requirement does not apply until the taxpayer claims the increased tax credit on its tax return. Thus, a taxpayer does not have to pay the worker for any shortfall the taxpayer discovers until it files its tax return (although the taxpayer may wish to pay earlier to stop the running of interest or to affect the determination of penalties as discussed below).⁵ The applicable penalties are due with the tax return. Whether taxpayers make the necessary correction payments and pay the penalty

⁵ In the case of tax credits transferred under section 6418, the requirements would have to be met by the filing of the transferor or transferee’s tax return, whichever is earlier.

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amounts promptly is one of the facts and circumstances considered for purposes of the increased penalties for intentional disregard (described more fully below).

Taxpayers may not be able to locate underpaid workers. This will not excuse the requirement to cure the defect. Treasury expects taxpayers to follow State procedures developed to address such cases.

If a wage underpayment is discovered by the IRS, the taxpayer would have 180 days to cure the defect after a final determination by the IRS. A final determination occurs on the date the IRS sends a notice to the taxpayer stating that the taxpayer has not satisfied the prevailing wage requirement.

The prevailing wage requirement will not apply if the taxpayer underpays a worker because it had not yet received a supplemental wage determination from the DOL and the taxpayer cures any defect within 30 days of the determination.

If the IRS determines that the taxpayer has not satisfied the prevailing wage requirement or any other requirement of the applicable tax credit, no penalties are due because the taxpayer is not qualified to claim the increased tax credit.

Waiver of penalty. – The proposed regulations provide that the \$5,000 per underpaid worker penalty can be waived. The penalty is waived if the taxpayer makes the correction payment within the earlier of 30 days after the taxpayer became aware of the error or the date the increased tax credit was claimed and either (1) the worker was underpaid for not more than 10 percent of his or her pay periods for the calendar year or (2) the worker was underpaid by no more than 2.5 percent of the amount required to be paid.

In addition, the \$5,000 penalty will also be waived with respect to work done pursuant to a qualified pre-hire collective bargaining agreement with one or more labor organizations and the correction payment is paid before the increased tax credit is claimed. The proposed regulations provide that a qualified pre-hire collective bargaining agreement must:

- Bind all contractors and subcontractors on the construction project through the inclusion of appropriate specifications in all relevant solicitation provisions and contract documents;
- Contain guarantees against strikes, lockouts, and similar job disruptions;
- Set forth effective, prompt, and mutually binding procedures for resolving labor disputes arising during the term of the project labor agreement;
- Contain provisions to pay prevailing wages;
- Contain provisions for referring and using qualified apprentices; and
- Be a collective bargaining agreement with one or more labor organizations that have building and construction employees as members.

Increased payments and penalties for intentional disregard. – If the underpayment of wages is as a result of an intentional disregard of the prevailing wage requirements, the wage correction payment is tripled and the \$5,000 per worker penalty is doubled. The proposed regulations provide that a failure to ensure that any laborer or mechanic employed in the construction, alteration, or repair of a qualified facility is paid wages at the prevailing wage rate is due to intentional disregard if it is knowing or willful, determined by considering all relevant facts and circumstances.

The facts and circumstances that are considered in determining whether a failure to satisfy the prevailing wage requirements is due to intentional disregard include whether:

- the failure was part of a pattern of conduct that includes repeated or systemic failures to ensure that the laborers and mechanics were paid wages at or above the applicable prevailing wage rate;
- the taxpayer failed to take steps to determine the applicable classifications of laborers and mechanics;
- the taxpayer failed to take steps to determine the applicable prevailing wage rate(s) for laborers and mechanics;
- the taxpayer promptly cured any failures to ensure that laborers and mechanics were paid wages not less than the applicable prevailing rates;
- the taxpayer has been required to make a penalty payment in previous years;
- the taxpayer undertook a quarterly, or more frequent, review of wages paid to mechanics and laborers to ensure that wages not less than the applicable prevailing wage rate were paid;
- the taxpayer included provisions in any contracts entered into with contractors that required the contractors and any subcontractors retained by the contractors to pay laborers and mechanics at or above the prevailing wage rates and maintain records to ensure the taxpayer's compliance with its recordkeeping requirements;
- the taxpayer posted in a prominent place at the facility or otherwise provided written notice to laborers and mechanics during the construction, alteration, or repair of the facility, of the applicable wage rates as determined by the DOL U.S. and that in order to be eligible to claim certain tax benefits, employers must ensure that laborers and mechanics are paid wages at rates not less than such wage rates; and
- the taxpayer had in place procedures whereby laborers and mechanics could report suspected failures to pay prevailing wages or suspected failures to classify workers in accordance with the wage determination of workers to appropriate personnel departments or managers without retaliation or adverse action.

Further, if a taxpayer makes the required correction and penalty payments before receiving notice of an examination from the IRS with respect to a claim for the increased credit, the taxpayer will be presumed not to have intentionally disregarded the prevailing wage requirements.

Apprenticeship requirements, in general

Section 45(b)(8) provides the apprenticeship requirements with respect to the construction of a qualified facility. These are: (1) a certain percentage⁶ of the total labor hours of the construction, alteration or repair work must be performed by qualified apprentices; (2) the use of apprentices satisfies the apprentice-to-journeyman ratio set by the DOL or applicable State agency; and (3) each taxpayer, contractor or subcontractor who employs four or more individuals for construction, alteration or repair work must employ at least one qualified apprentice. The proposed regulations provide that if the taxpayer exceeds the ratio described in (2), the hours of work by the excess apprentices cannot be taken into account under (1).

Good Faith Exceptions. – Section 45(b)(8)(D)(ii) and the proposed regulations provide a “Good Faith Exception” to the apprenticeship requirements. Under the exception, the apprenticeship requirements do not apply if a taxpayer, contractor, or subcontractor requests apprentices from a registered apprenticeship program and such request is not fulfilled. The proposed regulation detail how the exception operates:

- First, the taxpayer, contractor, or subcontractor must submit a written request for qualified apprentices to at least one registered apprenticeship program which has a geographic area of operation that includes the location of the facility, or to a registered apprenticeship program that can reasonably be expected to provide apprentices to the location of the facility; trains apprentices in the occupation(s) needed to perform construction, alteration, or repair with respect to the facility; and has a usual and customary business practice of entering into agreements with employers for the placement of apprentices in the occupation for which they are training, pursuant to its standards and requirements.

Such request must be in writing and sent electronically or by registered mail.

The request must include the proposed dates of employment, occupation of apprentices needed, the location and type of work to be performed, number of apprentices needed, the expected number of labor hours to be performed by the apprentices, and the name and contact information of the taxpayer, contractor, or subcontractor requesting employment of apprentices from the registered apprenticeship program. The request must also state that the request for apprentices is made with an intent to employ apprentices in the occupation for which they are being trained and in accordance with the requirements and standards of the registered apprenticeship program.

- The taxpayer will be deemed to have exercised a Good Faith Effort if the request is denied or no response is received. The exception is valid for a period of 120 days from the date of the request. The taxpayer will not be deemed to have exercised a Good Faith

⁶ The percentages are based on when construction of the facility started – 12.5 percent for 2023, and 15 percent thereafter.

Effort beyond 120 days of a previously denied request unless the taxpayer submits an additional request.

- A denial is valid if it is not the result of a refusal by the taxpayer or any contractors or subcontractors engaged in the performance of construction, alteration, or repair work with respect to such qualified facility to comply with the established standards and requirements of the registered apprenticeship program. In addition, the denial of a request is only valid for purposes of establishing a Good Faith Effort with respect to the portions of the request that were denied.
- If the registered apprenticeship program fails to respond to a request within five business days after the date on which such registered apprenticeship program received request, then the request is deemed to be denied. Acknowledgement, whether in writing or otherwise, by the registered apprenticeship program of receipt of such request submitted is a sufficient response.

“Cure” provision. – The failure to meet the apprenticeship requirements can be cured in a manner similar to the procedures applicable to the prevailing wage requirements. The taxpayer must pay the IRS a penalty equal to \$50 multiplied by the total labor hours for which the apprentice requirements were not satisfied with respect to the construction, alteration, or repair work on the qualified facility to retain the increased credit.

Avoidance of penalties. - The \$50 penalty payment required to cure a failure to satisfy the apprenticeship requirements does not apply with respect to the construction, alteration, or repair work of a qualified facility if the work is done pursuant to a qualifying project labor agreement described above.

Increased penalties for intentional disregard. – If the failure to meet the apprenticeship requirements is as a result of an intentional disregard, the \$50 penalty is increased to \$500.

Similar to the prevailing wage rules, the facts and circumstances that are considered in determining whether a failure to satisfy the apprenticeship requirements is due to intentional disregard include whether:

- the failure was part of a pattern of conduct that includes repeated and systemic failures to comply with the apprenticeship requirements;
- the taxpayer failed to take steps to determine the applicable percentage of labor hours required to be performed by qualified apprentices;
- the taxpayer sought to promptly cure any failures;
- the taxpayer has been required to make any penalty payments in prior years;
- the taxpayer included provisions in any contracts entered into with contractors that required the employment of apprentices by the contractor and any subcontractors consistent with the labor hour participation requirements; and

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- the taxpayer made no attempt to comply with the apprenticeship requirements.

If a taxpayer makes the applicable \$50 penalty payment before receiving notice of an examination from the IRS with respect to a claim for the increased tax credit the taxpayer will be presumed not to have intentionally disregarded the apprenticeship requirements.

Transferred credit. - If the taxpayer transferred the increased credit but has a penalty for not meeting the apprenticeship requirements, the obligation to pay the penalty remains with the eligible taxpayer (transferor). If the eligible taxpayer does not pay the penalties, then the eligible taxpayer was not entitled to the increased credit and the rules for an excessive transfer under section 6418 control.

Recordkeeping

The proposed regulations provide that the taxpayer must maintain and preserve records sufficient to demonstrate compliance with the applicable prevailing wage and apprenticeship requirements. At a minimum, those records include payroll records for each laborer and mechanic (including each qualified apprentice) employed by the taxpayer, contractor, or subcontractor in the construction, alteration, or repair of the qualified facility.

In addition, the proposed regulations provide that records sufficient to demonstrate compliance with the applicable prevailing wage requirements may include the following information for each laborer and mechanic (including each qualified apprentice) employed by the taxpayer, a contractor, or subcontractor with respect to each qualified facility:

- Identifying information, including the name, social security or tax identification number, address, telephone number, and email address;
- The location and type of qualified facility;
- The labor classifications the taxpayer applied to the laborer or mechanic for determining the prevailing wage rate and documentation supporting the applicable classification, including the applicable wage determination;
- The hourly rate(s) of wages paid (including rates of contributions or costs for bona fide fringe benefits or cash equivalents thereof) for each applicable labor classification;
- Records to support any contribution irrevocably made on behalf of a laborer or mechanic to a trustee or other third person pursuant to a bona fide fringe benefit program, and the rate of costs that were reasonably anticipated in providing bona fide fringe benefits to laborers and mechanics pursuant to an enforceable commitment to carry out a plan or program described in 40 U.S.C. 3141(2)(B), including records demonstrating that the enforceable commitment was provided in writing to the laborers and mechanics affected;
- The total number of labor hours worked per pay period;
- The total wages paid for each pay period (including identifying any deductions from wages);

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- Records to support wages paid to any apprentices at less than the applicable prevailing wage rates, including records reflecting the registration of the apprentices with a registered apprenticeship program and the applicable wage rates and apprentice to journeyworker ratios prescribed by the apprenticeship program; and
- The amount and timing of any correction payments and documentation reflecting the calculation of the correction payments.

Records sufficient to demonstrate compliance with the applicable apprenticeship requirements may include the following information for each apprentice employed by the taxpayer, a contractor, or subcontractor with respect to each qualified facility:

- Any written requests for the employment of apprentices from registered apprenticeship programs, including any contacts with the DOL's Office of Apprenticeship or a State apprenticeship agency regarding requests for apprentices from registered apprenticeship programs;
- Any agreements entered into with registered apprenticeship programs with respect to the construction, alteration, or repair of the facility;
- Documents reflecting the standards and requirements of any registered apprenticeship program, including the applicable ratio requirement prescribed by each registered apprenticeship program from which taxpayers, contractors, or subcontractors employ apprentices;
- The total number of labor hours worked by apprentices; and
- Records reflecting the daily ratio of apprentices to journeyworkers.