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insights

TYPES NOT MAPPED YET March 20, 2023 | TTR not mapped yet | Nicholas H. Kappas

Now is the time to electrify your commercial vehicles

The Inflation Reduction Act (IRA) provides a tremendous opportunity for commercial vehicle owners to begin the process of transitioning to an electric vehicle fleet. Beginning January 1, 2023, new Section 45W of the Internal Revenue Code of 1986, as amended (Code) authorizes tax credits of up to $40,000 per qualifying vehicle (for vehicles with a gross vehicle weight rating (GVWR) of 14,000 pounds or greater) and up to $7,500 per qualifying vehicle (for vehicles with a GVWR of less than 14,000 pounds) to taxpayers that acquire and place in service after December 31, 2022 a “qualified commercial clean vehicle.”

For those commercial vehicle owners seeking to transition to electric or hydrogen fuel cell commercial vehicles, Section 45W is relatively straightforward. Below are the basics.

The basics

Tax credit amount. Section 45W provides a tax credit for each “qualified commercial clean vehicle” (referred to below as a “clean vehicle”) acquired and placed in service in the U.S after December 31, 2022.

The amount of the tax credit is equal to the lesser of (A) or (B) below:

(A) 30% of the basis of the clean vehicle – in the case of any vehicle that is not powered by a gasoline or diesel internal combustion engine (i.e., a fully electric battery or fuel cell powered vehicle), or 15% of the basis of the vehicle – in the case of any hybrid vehicle (i.e., a vehicle powered by both an electric battery or fuel cell and an internal combustion gasoline or diesel engine powered vehicle), or

(B) the “incremental cost” of a clean vehicle.

The “incremental cost” of a clean vehicle is the amount by which the purchase price of the clean vehicle exceeds the purchase price of a comparable (in size and use) vehicle powered solely by a gasoline or diesel internal combustion engine.

How does one determine the incremental cost? Taxpayers may not necessarily be well situated to analyze the comparative costs of both types of vehicles. As a result, the IRS has stated in Notice 2023-9 that it will accept for the 2023 tax year, a taxpayer’s use of the incremental cost determinations published in the Department of Energy’s publication “2022 Incremental Purchase Cost Methodology and Results for Clean Vehicles” (DOE Report), which provides comparable costs for various types of commercial vehicles. The DOE Report can be found here.

Tax credit cap. The tax credit per clean vehicle is capped at $40,000 for a clean vehicle with a GVWR of 14,000 pounds or greater, and at $7,500 for a clean vehicle with a GVWR of less than 14,000 pounds.

Qualified commercial clean vehicle – defined. To boil down the requirements to their simplest, a clean vehicle must be (1) manufactured by a qualified manufacturer, (2) either a motor vehicle or certain mobile machinery, (3) either an electric vehicle or hydrogen fuel cell vehicle, in each case meeting certain performance requirements, and (4) depreciable (i.e., used in a trade or business or held for the production of income).

Let’s take a closer look at each of these four requirements:

1. The vehicle must be manufactured by a “qualified manufacturer”. The term “qualified manufacturer” means:

   - any “manufacturer” within the meaning of the Environmental Protection Agency’s regulations with respect to the Clean Air Act (a generally broad definition incorporating automobile manufacturers); and

- which enters into a written agreement with the U.S. Treasury Department (Treasury Department) pursuant to which the manufacturer agrees to make periodic written reports to the Treasury Department providing vehicle identification numbers (VINs) and any other required information related to each clean vehicle manufactured.

Understandably, taxpayers looking to acquire clean vehicles may not want to independently investigate whether a manufacturer is a "qualified manufacturer" under the above definition. The IRS recognizes as much and in Revenue Procedure 2022-42 has stated that it will allow any taxpayer acquiring and placing in service a clean vehicle to rely on the manufacturer's certification concerning its status as a qualified manufacturer (including in cases in which the certification is received by the IRS after the purchase of the vehicle). A taxpayer also may rely on the information and certifications contained in the qualified manufacturer's written reports. Additionally, a taxpayer can consult the index of qualified manufacturers published by the IRS that can be found here.

2. The vehicle must be one of the following:

- a "motor vehicle" (as defined in the Clean Air Act) that is manufactured primarily for use on public streets, roads, and highways and which has at least four wheels; or

- "mobile machinery," as defined in Section 4053(8) of the Code (generally referring to any vehicle with a chassis and certain permanently mounted machinery or equipment that is specially used in certain businesses such as construction, manufacturing, processing, farming, mining, drilling, timbering, or similar operation and is not used in public highway transportation).

3. The vehicle must meet one of the following two requirements:

- *Electric Vehicle.* The vehicle is an electric vehicle that is propelled to a significant extent by an electric motor that draws electricity from a battery with a capacity of not less than fifteen (15) kilowatt hours for a vehicle with a GVWR of 14,000 pounds or more (or seven (7) kilowatt hours for a vehicle which has a GVWR of less than 14,000 pounds) and is capable of being recharged from an external source of electricity; or

- *Hydrogen Fuel Cell Vehicle.* The vehicle is propelled by power derived from one or more hydrogen fuel cells and which, in the case of a passenger automobile or light truck, is certified as meeting certain Clean Air Act emission standards.

4. The vehicle must be depreciable. That is, the vehicle must be used in business or held for the production of income, but may not be inventory, stock in trade, investment property, or property used for personal purposes. However, this requirement does not apply to any vehicle placed in service by a tax-exempt entity (a state or federal government or agency, an organization exempt from tax, or Indian tribal government) that is not subject to a lease.

The depreciable basis of any clean vehicle for which a Section 45W credit is allowed must be reduced by the amount of the credit allowed and no section 45W credit is allowed for any vehicle for which a Section 30D clean vehicle credit is allowed.

Note that is not clear at this time whether federal and state grants to tax-exempt entities that are used for the purchase of the clean vehicle are includable in basis for purposes of calculating the credit, or are excluded from basis as an impermissible double benefit.

To claim the credit, taxpayer must include on the appropriate return, among other things, the VIN for the clean vehicle.

Lessors

To be eligible for the Section 45W credit, a clean vehicle must be acquired for use or lease by the taxpayer and not for resale. Thus, a taxpayer that is a lessor of clean vehicles in its business is eligible to claim the tax credits under Section 45W provided that, consistent with federal tax principles, the taxpayer is treated as the owner of the leased vehicles and the lease is respected as a true lease and not as a sale for federal tax purposes. Various factors must be considered in determining whether a lease is to be respected as a lease and not recharacterized as a sale for federal tax purposes, including the term of the lease relative to the economic life of the leased property and the existence and terms of purchase options. A discussion of these factors is beyond the scope of this summary.

We note that based on the updated IRS Fact Sheet, dated February 4, 2023, Section 45W credits may be available for owners that enter into vehicle leases that are treated as qualified motor vehicle operating agreements and contain a terminal rental adjustment clause (TRAC) under Section 7701(h) of the Code, provided that the vehicle lease otherwise meets the criteria to be respected as a true lease for federal tax purposes in the absence of the TRAC provision.

If a lessor is not eligible to claim the 45W credit because the relevant lease is treated as a sale of the clean vehicle for federal tax purposes, the lessee may be eligible to claim such credits.

Special tax rules

Recapture. There is no specific reference to recapture of tax credits in the text of Section 45W. However, Section 45W provides that "rules similar to" the rules under certain provisions of Code Section 30D (clean vehicle credit), also apply to Section 45W. Code Section 30D authorizes the IRS to draft regulations pertaining to recapture of the

Section 30D credit for “any property which ceases to be property eligible for such credit.” This regulatory authorization has been in place in Section 30D (both before and after the IRA’s changes to that Code section) for many years.

Treasury Regulation 1.30-1(eff. October 1994), which was drafted for an earlier version of Section 30D, provides some guidance as to potential recapture events that may be incorporated into any future regulations or guidance under Section 45W. At the present time, it is reasonable to anticipate that future guidance may require the Section 45W credit to be recaptured if the clean vehicle ceases to meet one or more of the requirements of a qualified commercial clean vehicle, including through subsequent modifications to such vehicle that adversely impact its qualification as an electric or hydrogen fuel cell vehicle, and dispositions that render the vehicle non-depreciable (e.g., sold or used for personal purposes). It does not appear likely that the failure of a manufacturer to retain its status as a qualified manufacturer after a sale will result in a recapture, particularly if the taxpayer is permitted to rely on certifications of such manufacturer. Otherwise, it remains to be seen how dispositions in the normal course of business to other commercial users and casualty events would be treated and whether a “recapture period” of one or more years after the tax year the clean vehicle is placed in service will be incorporated into such future provisions.

Direct pay. Owners of clean vehicles that fit within the definition of “applicable entity” in Code Section 6417 (primarily, tax-exempt organizations, state or local governmental entities, and Indian tribal governments, among several others) are eligible to receive the Section 45W credit by means of a direct payment from the Treasury Department in an amount equal to the applicable credit amount. The IRA authorized the direct payment method in Code Section 6417. Guidance as to how and when to make a claim for direct payment with the IRS is forthcoming.

No Section 45W credit is allowed for any clean vehicle acquired after December 31, 2032.

Section 45W promises to make the next 10 years a transformative period for commercial vehicle owners.

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