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Energy Tax Credits with a String Attached

By Heather Cooper and Rachel B. Cowen*

The authors discuss the prevailing wage and apprenticeship requirements for companies receiving credits under the Inflation Reduction Act of 2022 for clean energy and infrastructure projects.

The Inflation Reduction Act of 2022 (IRA) grants tax credits to clean energy and infrastructure projects. But there is a string attached: to receive the tax credits, workers doing the construction, as well as those doing any subsequent alteration or repair, must be paid the prevailing wages set under the Davis-Bacon Act. In addition, there are apprenticeship requirements that must be met for that work. Thus, attention to detail is critical when it comes to those prevailing wage and apprenticeship requirements.

WHICH PROJECTS ARE ELIGIBLE FOR THE TAX CREDITS?

Tax credits are available for:

1. Facilities that produce electricity from certain renewables (e.g., wind, biomass, geothermal, solar, landfill gas, trash, qualified hydropower or marine and hydrokinetic resources);
2. Energy storage facilities;
3. Industrial carbon capture or direct air capture facilities;
4. Energy-efficient upgrades to commercial buildings;
5. Dwellings that meet certain Energy Star efficiency standards;
6. Certain qualified nuclear power facilities;
7. Alternative vehicle refueling properties;
8. Qualifying advanced energy projects;
9. Clean hydrogen facilities; and
10. Clean fuel production facilities.

To qualify for the full credit amount, taxpayers must satisfy certain labor and apprentice requirements related to the "construction, alteration or repair" of such projects. Detailed guidance on what constitutes "construction, alteration

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or repair" is still outstanding. The Internal Revenue Service (IRS) issued guidance on November 30, 2022, referencing the Davis-Bacon Act regulations. There, under 29 CFR § 5.2(j), those terms are defined to include not only on-site construction but also:

- Painting and decorating;
- On-site manufacturing of material for the construction;
- On-site altering, remodeling and installation of items fabricated off-site; and
- Transportation between the work site and a facility dedicated to the construction of the building or work deemed a part of the work site.

WHAT IS THE PREVAILING WAGE OBLIGATION?

Under the Davis-Bacon Act, the prevailing wage is determined by the U.S. Department of Labor (DOL) locality by locality. Typically, it matches the wages set in union contracts and is a combination of the basic hourly rate and any fringe benefits. Prevailing wages must be paid to those workers whose duties "are manual or physical in nature (including those workers who use tools or who are performing the work of a trade), as distinguished from mental or managerial." Prevailing wage determinations are based on the type of construction applicable to the project and with detailed rates for each skill set within each type. For each worker, the actual duties must be mapped back to the most applicable labor classification in the DOL determination.[1]

WHAT IS THE APPRENTICESHIP REQUIREMENT?

This is where the IRA goes beyond the Davis-Bacon Act rules, which permit but do not require apprentices. The IRA goes further, setting both a ceiling (borrowed from Davis-Bacon) and two discrete floors that require minimums for apprentice work.

The ceiling is the ratio set by each apprenticeship program: "The allowable ratio of apprentices[2] to journeymen on the job site in any craft classification shall not be greater than the ratio permitted to the contractor as to the entire work force under the registered program."[3]

There is also a pair of floors that are unique to the IRA:

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[1] Illustrations of these can be found on the DOL's website; for example, here is the listing for Chicago: https://sam.gov/wage-determination/IL20230009/2.

[2] https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=75de1c6dda2f04f56ad916d6642db4b5&term_occur=999&term_src=Title:29:Subtitle:A:Part:5:Subpart:A:5.5.

[3] 29 CFR 5.5(a)(4)(i).

- Section 45(b)(8)(A)(i) sets a floor based on hours worked. Hours performed by qualified apprentices must be 10% (for projects that began before January 1, 2023); 12.5% (for projects that begin in 2023); or 15% (for projects that begin in 2024 and beyond) of the total covered work hours.
- Section 45(b)(8)(C) separately requires an additional floor that will impact smaller jobs or smaller work crews. Whoever employs four or more individuals must employ one or more qualified apprentices to perform such work.

There is one more major thing. Apprentices must come from an apprenticeship program registered with the DOL's Bureau of Apprenticeship and meet all the requirements of 29 CFR parts 29 and 30. Those are typically multiyear indentures where apprentices receive paid work experience and classroom instruction with progressive wage increases during that apprenticeship.

HOW WILL THE TAX CREDITS WORK?

There are two primary types of tax credits: (1) the investment tax credit (ITC), and (2) the production tax credit (PTC). The ITC is a one-time credit received when the project is placed into service. Whoever is the owner of the project at that time receives the credit. The PTC is an ongoing 10-year credit based on actual production from the facility and is calculated based on how much electricity is produced.

To receive the ITC, compliance with prevailing wage rates during the construction period and during the five-year period after the facility goes into service is required. To receive the PTC, compliance with prevailing wage rates is needed for all alteration and repair work during that 10-year period. These ongoing prevailing wage requirements will plainly impact operating costs.

The application of the apprenticeship requirements beyond initial construction is clouded by imperfect legislative drafting. Section 45(b)(7) addresses the "prevailing wage requirement" and is explicit in limiting the prevailing wage to post-construction "alteration or repair" only within the duration of the tax credit. Section 45(b)(8) addresses "apprenticeship requirements" but with no durational limit.

Applying those apprenticeship requirements in perpetuity is neither explicitly required nor needed for any statutory purpose. But, reading out the apprenticeship requirements for "alteration or repair" is difficult when that phrase appears twice in that section, even though the lead-in sentence is more limited (i.e., "The requirements described in this paragraph with respect to the construction of any qualified facility are. . . .").

This inartful drafting will likely be cured in due course with final regulations. Meanwhile, there is a practical answer to this ambiguity. First, "alteration or repair" will be later, not sooner. Second, taxpayers whose compliance with the apprenticeship requirement falls short do not lose the tax incentive but merely are subject to paying a penalty.

WHAT ARE THE CONSEQUENCES FOR NONCOMPLIANCE?

For violations of the prevailing wage requirements, the IRA requires taxpayers to (1) pay laborers the difference between the actual wage paid and the prevailing wage determined to be appropriate, with interest, and (2) pay a fine of $5,000 per worker. This penalty increases if the employer was found to have intentionally disregarded the prevailing wage provisions.

For violations of the apprenticeship requirements, the IRS will levy a penalty of $50 multiplied by the total number of hours during which the requirement was not met (e.g., if the apprentice minimum was missed by 1,000 hours, then the fine is $50,000.) This penalty increases to $500 for noncompliant hours if the taxpayer's violation is found to be intentional.

The IRA also provides a "good faith effort" exception to the apprenticeship requirements if the taxpayer can show (1) that it requested qualified apprentices from a registered apprenticeship program but was denied (for a reason other than that the taxpayer refused to comply with the program's requirements), or (2) the apprenticeship program failed to respond to the taxpayer's request within five business days.

NEXT STEPS

Entities contemplating taking advantage of these energy tax credits made available under the IRA will need to plan with that statute's twin obligations of prevailing wages and apprenticeship floors in mind. Those obligations are critical to qualify for these tax credits.

The IRA includes multiple references to the Davis-Bacon Act, and thus it is an important reference for taxpayers planning compliance with IRA requirements. To the extent the IRS decides to adopt the Davis-Bacon Act in its entirety (as it is relevant to IRA requirements), taxpayers will be able to look to those rules for planning purposes.

For construction, energy entities may prefer to hire contractors who are experienced with Davis-Bacon Act prevailing wage obligations and also participate in a DOL-approved apprenticeship program. Such contractors can simplify the obligations, which can be inserted into any agreement with such contractors along with indemnification for any shortfalls.

For post-construction "alteration or repair," it is important to track what work will be needed at each energy project. "Alteration or repair" sweeps

broadly in the context of the Davis-Bacon Act, but the regulations offer only gnomic guidance. Covered work includes "construction activity as distinguished from . . . servicing and maintenance work" but also includes "landscaping," even where no further construction will follow that landscaping.[4] Covered work also includes subsequent painting and decorating.[5]

For such covered post-construction work, again, it may be prudent to retain a contractor with Davis-Bacon Act experience. Alternatively, entities that undertake that work with their own staff will need to take the following steps to protect their tax credits:

- Determine which work falls within "alteration or repair";
- Determine the applicable prevailing wage for each worker;
- Prepare a weekly certified payroll with a record of precise hours worked;
- Pay for prevailing fringe benefits;
- Post required notices at work sites;
- Ensure appropriate apprentice ratios;
- Ensure that apprentices are registered in DOL-approved programs; and
- Timely cure violations.

Professor Milton Friedman, a Nobel laureate in economics, once famously quipped that "there ain't no such thing as a free lunch." Nor, he might add today, a tax credit without strings.

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[4] 29 CFR §5.2(i).

[5] 29 CFR §5.2(j).