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Highlights of the Final Regulations on Inflation Reduction Act Prevailing Wage and Apprenticeship Requirements

*By Nicole M. Elliott, Timothy Taylor, Amish Shah, Elizabeth Crouse, Brad M. Seltzer, Mary Kate Nicholson, Roger David Aksamit, Ryan Phelps, Joshua David Odintz, Daniel Graham Strickland, Kenneth W. Parsons, Alex Lewis and Rachel T. Provencher**

In this article, the authors examine the final regulations released recently for the “prevailing wage and apprenticeship” requirements under the Inflation Reduction Act.

The Inflation Reduction Act (IRA) significantly modified the tax incentives for developing clean energy projects, including by reducing the available tax credits to 1/5th of the amount otherwise available unless the “prevailing wage and apprenticeship” requirements (PWA Requirements) are satisfied. With the release of the final regulations for the PWA Requirements on June 25, 2024, clean energy project developers and other market participants have substantially clearer guidance regarding the labor rules that include paying specific workers a “prevailing wage” and employing a certain number of registered apprentices.

Although imposing certain labor rules in connection with federal contracts or the receipt of federal dollars has historically been commonplace, imposing labor rules and tying their satisfaction to tax incentives is novel. Even when Congress enacted a temporary program to provide cash payments in lieu of tax credits following the 2008 financial crisis under the “1603 grant program,” the U.S. Department of the Treasury specifically stated that compliance with the Davis-Bacon Act was not required. Satisfying the PWA Requirements does not happen by accident – it requires diligence, monitoring not only of taxpayer’s actions as they relate to construction, alteration, and repair of the project but also that of its contractors and any subcontractors. The stakes are high as following the PWA Requirements quintuples the relevant tax incentive, while falling short can expose the taxpayer to significant penalties and corrective payments. Thankfully the taxpayer can take curative measures should they discover any issues with workers’ wages or employment of registered apprentices.

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Many taxpayers therefore welcomed the issuance of final regulations detailing the PWA Requirements by the U.S. Department of Treasury and the Internal Revenue Service. The final regulations include additional helpful guidance and clarity, much of which is taxpayer-favorable.

The final regulations affect the PWA Requirements for the following tax incentives: Sections 30C, 45, 45L, 45Q, 45U, 45V, 45Y, 45Z, 48, 48C, 48E and 179D. Taxpayers with projects of more than one megawatt (MW) AC or that begin construction after Jan. 28, 2023,¹ should adopt practices to ensure satisfaction of the general rules depicted below.

GENERAL RULES AND CURATIVE ACTIONS

Prevailing Wage Requirement:

- Laborers and mechanics employed by the taxpayer, contractors and subcontractors in construction, alteration and repair of a facility or project must be paid wages not less than prevailing rates as determined by the Secretary of the U.S. Department of Labor (DOL).
- As a curative measure taxpayers can pay back wages and interest to workers and must pay a \$5,000 penalty per underpaid worker to the IRS (the penalty is enhanced if the IRS determines that the Prevailing Wage Requirement was intentionally disregarded).

Apprenticeship Requirements (Three Separate Requirements)

- First, 10 percent to 15 percent of labor hours, depending on the beginning of construction date, for the facility's construction must be performed by registered apprentices. Supervisor, owner and administrative hours are not used for purposes of calculating the percentage. (Referred to as the Labor Hour Requirement.)
- Second, any entity employing registered apprentices must meet any apprenticeship ratios in the relevant DOL- or state-approved Registered Apprenticeship program. (Referred to as the Ratio Requirement.)
- Third, if the taxpayer or any contractors or subcontractors employ four or more individuals for construction then they must employ at least one qualified apprentice. (Referred to as the Participation Requirement.)
- As a curative measure taxpayers can pay a penalty to the IRS for underuse of registered apprentices (the penalty is enhanced if the IRS determines that the Apprenticeship Requirements were intentionally

¹ Referred to as the BOC Safe Harbor Exception, facilities or projects that began construction prior to Jan. 29, 2023 are exempt from the PWA Requirements.

disregarded).

- Importantly, there is a Good Faith Effort Exception available under which taxpayers are deemed to satisfy the Apprenticeship Requirements if, in short, they ask each year for Registered Apprentices from a source that supplies such apprentices but do not get them.

The following provides additional insight on the final regulations, with a particular focus on how the final regulations differ from those proposed in August of 2023.

FINAL REGULATIONS AND THE PREVAILING WAGE REQUIREMENT

Generally conforming to prior guidance, the final regulations:

- Clarify that the prevailing wage requirements apply not only to those laborers and mechanics and who are considered employees, but also to those who are considered independent contractors. They also generally adopt the definitions of “laborer or mechanic” and “construction, alteration or repair” as previously announced.
- State that prevailing wages must be paid not only to those laborers and mechanics on-site, but also to workers on secondary sites in specific circumstances.
- State that the prevailing wage must be paid at the time the construction, alteration or repair begins.

The final regulations clarify that the PWA Requirements apply once construction begins (which, for this purpose, does not utilize the tax definition). That is, unless an exception applies, taxpayers are required to comply with the PWA Requirements once a laborer or mechanic performs any work that is considered construction, alteration or repair of the qualified facility or project. Thereafter, all work with respect to the construction, alteration or repair is subject to the applicable PWA Requirements.

Changes and clarifications in the final regulation include:

- While the proposed regulations stated that taxpayers and their contractors should use the prevailing wages in effect at the time the construction, alteration or repair begins, the final regulations provide that taxpayers and their contractors should use the prevailing wages in effect at the time the contract is entered for the construction, alteration or repair of the facility or project is executed.
- While the proposed regulations required that updated prevailing rates must be followed if the contract is modified, the final regulations

narrow the circumstances to exclude situations where the contractor (or subcontractor) is simply given more time to complete the contemplated work or where there is additional work if such additional work is merely incidental.

- The final regulations adjust the timeframe for supplemental wage determinations. Under the proposed regulations, the supplemental wage determination was to be made prior to beginning of construction. Under final regulations, supplemental wage determinations may be sought from DOL no more than 90 days before the contract between taxpayer and contractor is signed and the work is expected to be executed and require that the supplemental wage determinations received from DOL are required to be incorporated into the contract within 180 days.
- The final regulations clarify that requests for additional worker classifications and wage rates follow a similar but separate process from requests from supplemental wage determinations. Requests for additional classifications can happen at any time, although taxpayers and their contractors are encouraged to request one as soon as they realize they need it, but no earlier than 90 days before work begins.
- The final regulations make revisions to the penalty waiver such that there is no penalty for failure to meet the prevailing wage requirement if a corrective payment is made to the mechanic or laborer by the last day of the first month following the end of the quarter in which the failure occurred.

FINAL REGULATIONS AND THE APPRENTICESHIP REQUIREMENTS

Generally conforming to prior guidance, the final regulations:

- Confirm that the Labor Hours Requirement applies to all work hours related to construction, alteration or repair of the facility or project prior to it being placed in service and need not be met on a contractor-by-contractor or trade-by-trade basis.
- Clarify that the Participation Requirement – which generally requires each taxpayer, contractors or subcontractor who employs four or more individuals to perform construction, alteration or repair work to employ one or more qualified apprentices to perform that work – does not require that such employment occur at the same time or location.
- Dictate that taxpayers must pay apprentices at least the rate specified by the registered apprenticeship program according to their level of

progress for their classification in the applicable wage determination, including bona fide fringe benefits as applicable. Apprentices may be paid at less than the prevailing rate for work performed consistent with the occupation of the registered apprenticeship program if they are: 1) qualified apprentices from a registered apprenticeship program who perform work with respect to the construction, alteration or repair of a qualified facility, or 2) individuals in the first 90 days of probationary employment as an apprentice in a registered apprenticeship program who have been certified by DOL.

- Confirm that taxpayers (and their contractors or subcontractors) can rely on the Good Faith Effort Exception. Under the exception the taxpayer, contractor or subcontractor must make a request to a registered apprenticeship program and either (1) the request for apprentices was denied for reasons other than the taxpayer, contractor or subcontractor's refusal to comply with the program's standards and requirements, or (2) the program failed to respond within five business days of receiving a request.

Changes and clarifications in the final regulation include:

- Of great importance, the final regulations state that the apprenticeship requirements only apply to construction, alteration and repair of the facility or project prior to the facility being placed in service; once placed in service the apprenticeship requirements do not apply.
- Although the proposed regulations stated that the Good Faith Effort Exception lasted 120 days, under final regulations the exception lasts 365 days (366 days in the case of a leap year). In other words, taxpayers (and their contractors and subcontractors) need ask for registered apprentices only once per year.

FINAL REGULATIONS ON DOCUMENTATION AND OTHER KEY POINTS

The final regulations offer some additional clarity on the following points:

- They confirm that the obligation to satisfy the PWA Requirements becomes legally binding upon the filing of the tax return claiming the increased tax credit or deduction (or in the case of a transfer, on the filing of the transferee taxpayer's return).
- They clarify and add factors that will be considered by the IRS in determining whether there has been intentional disregard of the PWA Requirements (thereby triggering, inter alia, higher penalty amounts). The final regulations added, for instance, under the prevailing wage

rules whether the taxpayer utilizes a previously disbarred contractor or with respect to apprenticeship requirements whether taxpayer regularly reviewed contractors' and subcontractors' use of qualified apprentices.

- They confirmed the scope of the PWA Requirements –
 - Specifically that the rules only apply to the portion of activity that is creditable or deductible. This means, for example, only a portion of the facility or project used to produce the tax credit is subject to the PWA Requirements.
 - Excepted any work (construction, alteration or repair) performed prior to January 29, 2023 from the PWA Requirements.
- They confirmed the duration of the PWA Requirements. For example under Section 30C, 45L, 48C and 179D, there are no PWA obligations related to repair or alteration once the project or facility is placed in service. By contrast under Section 45 or 48, the PWA Requirements apply during the 10-year credit period or five year recapture prior, respectively.

OBSERVATIONS ON FINAL REGULATIONS

Most of the rules contained in the final regulations were taxpayer favorable. Notably, the application of the apprenticeship requirements solely to construction, alteration or repair prior to the facility or project being placed in service was a significant and welcome change. Similarly, exempting all work (construction, alteration, or repair) completed before January 29, 2023 from the PWA Requirements was also helpful. Finally, allowing taxpayers to rely on the Good Faith Efforts Exception for 365 days verses the proposed 120 days before being required to review a request for registered apprentices will ease taxpayer, contractor, and subcontractor burden.

One of the more surprising and less favorable developments in the final regulations relates to when the PWA Requirements are triggered. The final regulations provide that taxpayers are required to comply with the PWA Requirements once a laborer or mechanic performs any work that is considered construction, alteration, or repair of the facility (including work on the facility that occurs at a secondary site). Thereafter, all work with respect to the construction (or alteration or repair) of the facility is subject to the PWA Requirements.

Thus, the final regulations make clear that the PWA Requirements are triggered based on the Davis-Bacon Act (DBA) definition of “construction,” located at 29 CFR § 5.2. Under the DBA, construction, completion, or repair is defined expansively to include “all types of work” done on a particular

building or work at the site of the work, including altering, remodeling, installing of items fabricated offsite; painting and decorating; manufacturing or furnishing of materials, articles, and supplies or equipment on the site of the work; and certain demolition or removal activities. Prior to this clarification, many taxpayers believed that the PWA Requirements were triggered at the “beginning of construction” under longstanding tax guidance. The DBA definition is more expansive, thus potentially triggering the PWA Requirements earlier. In particular, certain preliminary activities that are not considered the “beginning of construction” under traditional tax guidance, such as demolition and removal of an existing building, are considered “construction” triggering the PWA Requirements.

Thankfully, the final regulations provide a transition rule for application of the DBA definition of construction. Under the transition rule, any penalty payments that may be owed to cure a failure to satisfy the Prevailing Wage Requirement are waived with respect to a laborer or mechanic who performed work in the construction, alteration, or repair of a facility on or after January 29, 2023, and prior to June 25, 2024.

The clarified and expanded intentional-disregard factors provide additional compliance guidance to taxpayers, contractors, and subcontractors, albeit with attendant compliance burdens. While each factor is not in and of itself a binding requirement, read together they indicate an IRS-preferred compliance regime to mitigate the risks of incurring intentional-disregard penalties. For instance, the factors strongly encourage taxpayers to review contractors' and subcontractors' compliance and records at least quarterly, whether directly or by employing a third-party expert. The factors also strongly encourage taxpayers to provide notice to workers of their prevailing-wage and whistleblower rights, and to diligently review any complaints that the PWA Requirements are being violated.

DIFFERENCES OF THE PWA AMONG CREDITS

While the PWA Requirements are generally the same for the tax incentives identified above, there are some exceptions. That is, not all tax incentives implicate the same exact PWA Requirements. For example under Section 45U, the zero emission nuclear power production credit does not require compliance with the Apprenticeship Requirements. Under Section 45Z there is no BOC Safe Harbor that applies, exempting from the PWA Requirements facilities or projects that began construction prior to Jan. 29, 2023. Importantly while the PWA Requirements apply under Section 48 or 48E (the investment tax credits) and Section 45 or 45Y (the production tax credits) during the 5-year recapture period or 10-year credit period, respectively, the final regulations state Sections 30C, 45L, 48C, and 179D, do not require the payment of wages at rates not

less than the prevailing rates after construction, re-equipping, expansion, establishment, or installation, as applicable, ends. Therefore, taxpayers should take care to understand the differences in PWA Requirements depending on the credit at issue.

CONCLUSION

The PWA Requirements, while borrowing from a historic framework, present an interesting new interaction between the tax code and labor rules. While compliance certainly requires effort and places new burdens on taxpayers, the final regulations are helpful insofar as they create certainty and included some taxpayer-favorable changes. The taxpayer-favorable changes, coupled with the corrective actions built into the statute and implemented through the final rules, mean that most taxpayers should be able to achieve the PWA Requirements, unlocking their potential to maximize the IRA's tax incentives. However, care must be given by project developers and other market participants to ensure through contractual agreements and proper recordkeeping that the PWA Requirements will be satisfied and supportable.