

Insights

INDUSTRY UPDATE: PWA GUIDANCE

May 23, 2023

The Inflation Reduction Act (the “**IRA**”), which was signed into law in August of 2022, has been top of mind for members of the renewable energy industry. This is because, among other things, the IRA significantly restructured the production and investment tax credit system that drives the economics of many renewable energy projects. Tantamount amongst the changes is the establishment of the prevailing wage and apprenticeship requirements (the “**PWA Requirements**”) that must be satisfied for projects using the Production Tax Credit (the “**PTC**”) under Section 45 and 45Y of the Internal Revenue Code (the “**Code**”) and the Investment Tax Credit (the “**ITC**”) under Section 48 and 48E of the Code to maximize the PTC and ITC benefits.^[1] Generally, the PWA Requirements apply to laborers and mechanics used in constructing, and in certain post-construction work on, projects that are 1 MW or larger and begin construction on or after January 29, 2023.^[2] To aid developers and other stakeholders in complying with the PWA Requirements, the Treasury and the Internal Revenue Service published *Notice 2022-61* (the “**Notice**”) on November 30, 2022. The Notice sets forth the PWA Requirement parameters and details regarding permitted exceptions to compliance.

While the Notice provides a helpful starting point, industry members are eagerly awaiting further guidance as there is still ambiguity regarding aspects of the compliance parameters. One thing is clear, however, and that is in order to obtain the applicable increased credit amount for a PTC or ITC project, the taxpayer must either comply with the PWA Requirements or fit within one of the enumerated exceptions (as discussed in more detail below). It is, therefore, incumbent on affected developers, investors and other stakeholders alike to garner an understanding of the PWA Requirements to ensure their projects can fully capitalize on the tax incentives.

PWA REQUIREMENTS

The PWA Requirements require companies to pay the prevailing wage rates (equal to the Department of Labor’s (the “**DOL**”) Davis Bacon Act prevailing wage and fringe benefit rates for the applicable classifications of laborers and mechanics in the area where the project is located) and employ qualified apprentices to perform construction, alteration, and repair work in the construction of the project. In addition to the requirement to pay prevailing wages during the construction of the project, the prevailing wage requirement applies to alterations and repairs of the project in any year

that is within the 10-year production tax period (for the PTC) and the five-year ITC recapture period (for the ITC), in each case, beginning on the date the project is placed in service.

The DOL determines the prevailing wage and fringe benefit rates in certain geographic areas by surveying local wages and benefits paid or provided to similarly situated laborers and mechanics. Compliance with the PWA Requirements, therefore, begins with consulting the DOL's published prevailing wage requirements applicable to the time period and region where the project is located. If the DOL has not published information for the particular area or for a particular work classification in a particular area, a project-specific wage determination can be requested by contacting the DOL at IRAprevailingwage@dol.gov. Any such request must include the project type, location, proposed labor classifications, proposed prevailing wage rates, job descriptions and duties, and the rationale for the proposed classifications.

The apprenticeship requirements, on the other hand, require the taxpayer (or any of its contractors or subcontractors) to employ apprentices from a registered apprenticeship program for a specified percentage of the total labor hours of the construction, alteration or repair work undertaken with respect to the construction of the project. This typically involves contacting the apprenticeship program with a description of the project and a request for available apprentices. The apprenticeship program then exercises its discretion to authorize the use of certain apprentices, which may be granted with conditions. Unlike journeyworker laborers and mechanics, the required wage rates for registered apprentices are specified by the applicable apprenticeship programs (rather than the DOL), which may result in lower wages for apprentices than those required for journeyworkers.

For projects that started construction before January 1, 2023, 10% of total labor hours must be performed by qualified apprentices, and for projects that start construction in 2023, the percentage of total labor hours that must be performed by qualified apprentices is 12.5%. This figure increases to 15% for projects starting construction during or after 2024. The foregoing requirements are subject to any applicable requirements for apprentice-to-journeyworker ratios of the DOL or the applicable State apprenticeship agency. In addition, each taxpayer, contractor or subcontractor that employs four or more individuals to perform construction, alteration or repair work with respect to the construction of a project is required to employ one or more qualified apprentices to perform that work.

A taxpayer may qualify for exemption from the apprenticeship component of the PWA Requirements if the taxpayer issues a request to the appropriate registered apprenticeship program and such request (i) goes unanswered for five business days after the apprenticeship program's receipt of the request or (ii) is denied (except if such denial pertains to the taxpayer's (or associated requesting party's) refusal to comply with the requirements of the apprenticeship program). This is referred to as the "good faith effort exemption".

Compliance is key to ensure the economic incentives of the project are realized. Failure to comply will relegate the project to the lower tier tax credit (i.e. one-fifth of the tax credits that would be available if the PWA requirements are satisfied) and, in the case of the ITC, recapture of tax credits previously claimed. A taxpayer can rectify inadvertent non-compliance by paying laborers and mechanics the difference between the actual wages paid and the prevailing wage (including fringe benefits), with interest, and paying a fine of \$5,000 per labourer or mechanic that was underpaid. The penalties increase substantially if the non-compliance was intentional. The IRA also imposes a fine for failure to meet the apprenticeship requirement equal to \$50 for each labor hour during which the apprenticeship requirement was not met. Again, the penalty increases substantially for intentional non-compliance.

PWA COMPLIANCE EXCEPTIONS

There are exceptions to compliance for both the prevailing wage and apprenticeship components of the PWA Requirements.

Projects that start construction before January 29, 2023 (i.e., 60 days after the Notice was issued) are exempt from the PWA Requirements. Project developers may rely on either the pre-existing physical work test or the 5% safe harbor threshold described in prior IRS guidance to satisfy the “start of construction” exception.^[3]

The physical work test mandates there be “physical work of significant nature” on a project. The focus is on the actual work performed, rather than the cost of such work. Preliminary work will not be considered, which includes (but is not limited to) work associated with planning or designing, securing financing, exploring, researching, obtaining permits, licensing, conducting surveys, environmental and engineering studies, or clearing a site. Third party work performed under a binding written contract that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer or for the taxpayer’s production of income may qualify, including work performed “off-site”. Physical work of a significant nature does not include work to produce property that is either in existing inventory or is normally held in inventory by a vendor.

The 5% safe harbor threshold, on the other hand, focuses directly on the costs incurred, and the threshold will be satisfied if 5% or more of the total costs of the project are incurred. All costs properly included in the depreciable basis of the project are taken into account to determine whether the 5% safe harbor threshold has been met. Costs incurred by a third party for property that is manufactured, constructed or produced for the taxpayer by such third party under a binding written contract with the taxpayer before the property is provided to the taxpayer are deemed incurred by the taxpayer when the costs are incurred by the third party under the principles of Section 461 of the Code.

If the start of construction is established pursuant to the foregoing, then, in order to maintain such start of construction date, the project is required to demonstrate continuous construction to

completion.^[4] This is referred to as the “continuity requirement”, and it is determined based on the facts and circumstances of each case. Given the risk associated with non-compliance, the IRS Notices establish a “continuity safe harbor” threshold, which provides for satisfaction of the continuity requirement if the project is placed in service within a specified timeframe after the project started construction pursuant to the physical work test or the 5% safe harbor threshold.

REMAINING AMBIGUITY IN THE PWA REQUIREMENTS

While the Notice provided much needed compliance clarification in many respects, there is still ambiguity in critical areas. For instance, the scope of work subject to the PWA Requirements remains unclear as there is circularity between the definitions used in the Notice and the external sources referenced therein. The Notice also fails to specify the breadth of work in the overall project that is subject to the apprenticeship requirements, and whether a requesting party needs to submit requests to all registered apprenticeship programs within an area (if there are multiple) or if a single request will satisfy the good faith exception. In addition, existing DOL wage determinations do not include specific wage classifications for certain types of work performed by laborers and mechanics on renewable energy construction projects. The Notice specifies that the IRS intends to publish proposed regulations with respect to the PWA Requirements, which have not yet been issued. Until these and other questions are answered through further guidance, industry members would be wise to err on the side of caution to ensure compliance.

SUFFICIENT RECORDS

One thing the Notice makes abundantly clear is the requirement for sufficient record keeping to establish compliance with the PWA Requirements. The records should include, among other information, (i) the identity of the laborers and mechanics that perform construction, alteration or repair work on the project, the classifications of work they perform, their hours worked in each classification, the applicable wage determination(s), and the wage rates paid for the work, (B) the total labor hours of the construction, alteration or repair work on the project, the percentage and total number of such labor hours performed by qualified apprentices, the total number of individuals (including apprentices) employed to perform such work, the total number of such individuals that are apprentices and the total number that are journeyworkers, and any applicable apprentice-to-journeyworker ratios of the United States Department of Labor or the applicable State apprenticeship agency, (C) to the extent the taxpayer or any contractor or subcontractor is relying on a good faith effort exemption from compliance with the apprenticeship requirements, supporting documentation establishing the entitlement to the good faith effort exemption, and (D) such other information, if any, as may be required by future guidance or regulations issued by the IRS. The record keeping requirement applies not only to the taxpayer, but also to any contractors and subcontractors performing the work. Failure to keep and preserve sufficient records (or to cause contractors and subcontractors performing the work to do the same) may result in a failure to satisfy the PWA Requirements.

DRAFTING AND NEGOTIATION CONSIDERATIONS

In drafting and negotiating project documents associated with renewable energy projects subject to the IRA tax credits, the party seeking to take advantage of the tax credit should be acutely mindful of the provisions related to PWA Requirement compliance. This includes provisions in any document pertaining to work to be performed that relates to the project, such as EPC, BOP and other construction contracts, service and maintenance agreements, and operating and maintenance agreements. For projects that have a start of construction date before January 29, 2023, taxpayers should be aware of the risk of delays pushing the placed in service date past the deadline for reliance on the continuity safe harbor, in which case the taxpayer will have to demonstrate a continuous program of construction (for projects relying on the physical work test) or continuous efforts to advance towards completion of the facility (for projects relying on the 5% safe harbor) under the facts and circumstances test, or demonstrate compliance with the PWA Requirements to be entitled to the increased tax credit amounts.

Taxpayers should include provisions in their contracts requiring contractors to (i) regularly document and report on compliance with the PWA Requirements by such contractors and their subcontractors during the course of construction of the project, which will allow the taxpayer to actively oversee the compliance process and catch non-compliance early on (and thereby minimize the risk of having to cure noncompliance years after the project is completed, when contractors, subcontractors, laborers and mechanics have moved on), (ii) maintain and provide records and documentation necessary to establish compliance with the PWA Requirements, and (iii) cooperate with the taxpayer in the event of an audit or dispute with the IRS with respect to compliance with the PWA Requirements.

For related inquiries, please contact Fraser Wayne or Peter Hansen.

[1] The IRA established a two-tier tax credit regime, with a base credit available for all qualifying projects, and a credit equal to a multiple of five of the base credit for projects satisfying the PWA Requirements.

[2] Similar requirements apply to credits and deductions, as applicable, under Sections 30C, 45L, 45Q, 45U, 45Z and 179D of the Code.

[3] Prior IRS guidance with respect to the physical work test and the 5% safe harbor threshold includes Notice 2013-29; clarified by Notice 2013-60; clarified and modified by Notice 2014-46; updated by Notice 2015-25; clarified and modified by Notice 2016-31; updated, clarified and modified by Notice 2017-04; Notice 2018-59; modified by Notice 2019-43; modified by Notice 2020-41; clarified and modified by Notice 2021-5; clarified and modified by Notice 2021-41 (collectively, the “IRS Notices”).

[4] The IRS Notices phrase the obligation as a continuous program of construction for projects relying on the physical work test and as a requirement to use continuous efforts to advance towards completion of the facility for projects relying on the 5% safe harbor threshold.

RELATED PRACTICE AREAS

- Energy & Natural Resources
- Environment
- Infrastructure

MEET THE TEAM



Fraser F. Wayne

Denver

fraser.wayne@bcplaw.com

+1 303 866 0274



Peter O. Hansen

Denver

peter.hansen@bcplaw.com

+1 303 866 0206



Paul E. Smith

Boulder / Denver

paul.smith@bcplaw.com

+1 303 417 8508

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