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INSIGHT

Foreign Entity of Concern Requirements in the Section 30D Clean Vehicle Credit

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The Inflation Reduction Act (IRA; P.L. 117-169) made significant changes to the clean vehicle credit (CVC) in Section 30D of the Internal Revenue Code (IRC). The CVC allows individuals and businesses to reduce their federal income taxes by either $7,500 or $3,750 for purchases of qualifying new electric vehicles (EVs).

To qualify for the CVC, vehicles acquired after 2023 cannot use battery components manufactured or assembled by a *foreign entity of concern* (FEOC). Similarly, for vehicles acquired after 2024, critical minerals in the vehicles' batteries cannot have been extracted, processed, or recycled by an FEOC. This Insight describes both the CVC's FEOC requirements and the Internal Revenue Service's (IRS's) regulatory enforcement of those requirements.

Foreign Entities of Concern: Definition and Key Issues

The term *foreign entity of concern* describes nonstate actors potentially posing economic or security threats to the United States. Terrorist groups, for example, are classified as FEOCs; so too are businesses significantly influenced by the governments of China, Russia, North Korea, or Iran (known as "covered nations").

At present, the input markets for battery components and critical minerals are dominated by China. Recent research finds that 65% of all EV battery components are made in China, and China refines roughly two-thirds of the nickel, lithium, and cobalt used in EV batteries. Department of Energy and U.S. Geological Survey data also suggest that China produces most of the world's aluminum, gallium, graphite, magnesium, and silicon—all of which are used in EV batteries.

IRC Section 30D left certain aspects of the FEOC requirements to regulatory interpretation. First, Section 30D states that the term *FEOC* is "as defined in ... 42 U.S.C. 18741(a)(5)," with 42 U.S.C. §18741(a)(5) in turn stating that companies are FEOCs if they are "owned by, controlled by, or subject to the jurisdiction or direction of a government of a foreign country that is a covered nation." For companies that operate in multiple countries or have owners in multiple countries, 26 U.S.C. §30D and 42 U.S.C. §18741(a)(5) do not clarify the exact point at which the company is deemed to be "owned by, controlled by, or subject to the jurisdiction of" a covered nation's government. The CHIPS and Science Act (P.L.

117-167) subjects companies to certain restrictions if 25% or more of their stock, voting shares, or board seats are owned by individuals or businesses in a covered nation. In general, organizations pushing for greater EV uptake called for higher ownership thresholds in the Section 30D regulations, while proponents of domestic manufacturing called for lower thresholds. The maximum ownership share would apply not just to the companies receiving the CVCs but also to companies they purchase materials from (as part of their supply chains).

Second, EV producers (and their supporters) argued that they should be allowed to draw a small share of critical minerals from FEOCs without violating the ban. They argued that it is difficult to trace all critical minerals back to their original sources, so companies should not be penalized if their FEOC mineral sourcing remains under a low *de minimis* threshold. Domestic energy suppliers and miners argued against such a threshold.

IRS Regulations

In December 2023, the IRS published a proposed rule defining FEOC and setting limits on interactions with FEOCs for purposes of the CVC. Final regulations were issued in May 2024 and took effect on July 5, 2024.

Under the final regulations, a business is to be classified as an FEOC if it is "incorporated in, headquartered in, or performing the relevant activities" ("the relevant activities" including things like manufacturing, production, extraction, etc.) in a covered nation. The regulations also classify businesses as FEOCs if 25% or more of their "board seats, voting rights, or equity interest" are cumulatively held by a covered nation's national government, a covered nation's subnational governments, or "certain current or former senior foreign political figures" from a covered nation. Finally, the regulations stipulate that a business may be classified as an FEOC if it has licensing agreements or contracts with an FEOC that effectively "create control" of the business for the FEOC. One analysis of the proposed rule (which closely resembled the final regulation) stated that, based on these definitions, "foreign subsidiaries of privately-owned Chinese companies in non-FEOC countries" could form part of credit-eligible businesses' supply chains "so long as they are not controlled by the Chinese government" (link requires paid subscription). According to the same analysis, the world's largest nickel producer and largest cobalt miner, respectively, are both privately owned Chinese companies that operate in foreign countries and would not be classified as FEOCs.

Based on the final regulations, if a vehicle manufacturer intentionally violates the FEOC ban, its unsold vehicles will become ineligible for the CVC. At its discretion, the IRS could render other future vehicles produced by the firm ineligible as well.

The final regulations do not include a *de minimis* exception. However, through the end of 2026, EV manufacturers are not required to report the origins of certain "impracticable-to-trace battery materials" that are often commingled in the battery production process. The IRS's final regulations define such materials as "graphite contained in anode materials and applicable critical minerals contained in electrolyte salts, electrode binders, and electrolyte additives." The IRS's proposed rule previously noted that "exemplar materials" (defined similarly) "account for less than two percent of the value of applicable critical minerals" in EV batteries.

Vehicle Eligibility Trends After the FEOC Battery Components Ban

Although the FEOC critical minerals ban is not to take effect until 2025, the FEOC battery components ban went into effect on January 1, 2024. Many EV models temporarily became ineligible for the credit after the ban took effect, though the number of credit-eligible vehicles increased over the following months (perhaps due to lags in supply-chain adjustments). As of August 27, 2024, 26 EV models were eligible for the full $7,500 CVC, up from 18 in January 2024 and roughly on par with 27 from the end of 2023. Similarly, 20 EV models were eligible for partial credits of $3,750, up from 9 at the beginning of 2024 and 16 at the end of 2023. Year-over-year changes are not exclusively attributable to the FEOC battery components ban, as the CVC changed in other minor ways at the beginning of 2024. The long-term effects of the FEOC bans may also differ from their short-term effects as supply chains have additional time to adjust.

How Leased EVs Evade the FEOC Bans

The FEOC bans apply to the CVC (IRC §30D) but not to the credit for qualified commercial clean vehicles (IRC §45W). The latter credit is claimed by businesses using EVs in the ordinary course of business or leasing EVs to customers. Car dealers may therefore claim the Section 45W credit for vehicles that do not meet the FEOC requirements; they may then pass the gains to consumers by leasing non-FEOC-compliant vehicles at reduced prices. No similar option exists for consumers purchasing rather than leasing EVs. Dealers and customers alike reference *the EV leasing loophole* or *the EV tax credit exception*.

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