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The Tax Credit Exception for Leased Electric Vehicles

The Inflation Reduction Act (IRA; P.L. 117-169) created or modified three tax credits for purchases of electric vehicles (EVs): the clean vehicle credit (CVC), the used clean vehicle credit (UCVC), and the credit for qualified commercial clean vehicles (CQCCV). These credits were intended to both reduce greenhouse gases and promote domestic industry, policy initiatives that at times conflicted with each other.

This In Focus describes one such conflict: the exception for leased electric vehicles. Since businesses could claim the CQCCV for vehicles leased to customers, car dealers could pass tax savings to individuals who leased vehicles that were ineligible for the CVC. Because the CVC had certain “made in America” requirements and other restrictions not present in the CQCCV, the leased vehicles exception may have promoted larger emissions reductions at the expense of domestic industry.

All three EV tax credits were repealed in the FY2025 reconciliation law (P.L. 119-21), sometimes referred to as the One Big Beautiful Bill Act. To qualify for the tax credits under the law, vehicles must have been acquired on or before September 30, 2025. (The IRA previously authorized the credits through the end of 2032.) As such, this “tax credit exception” or “leased vehicles loophole” (as it was sometimes called) was implicitly repealed as well.

Clean Vehicle Credit Requirements

The CVC allowed taxpayers to receive up to \$7,500 for purchasing new EVs. Eligible EVs must have been made by a qualified manufacturer, weighed less than 14,000 pounds, had four or more wheels, and been intended for use on public streets, roads, and highways. Electric boats, motorcycles, and bicycles did not qualify for the credit.

The CVC did not apply to all EVs. Rather, it applied to EVs meeting certain domestic content and manufacturing requirements. The \$7,500 total credit was the sum of two smaller credits: a \$3,750 credit for vehicles meeting the *critical minerals requirement* and a \$3,750 credit for vehicles meeting the *battery components requirement*. To meet the critical minerals requirement, a certain percentage of the critical minerals in an eligible EV’s battery must have been extracted or processed in the United States, extracted or processed in a country with which the United States has a free trade agreement, or recycled in North America. To meet the battery components requirement, a certain share of an EV battery’s component parts must have been manufactured or assembled in North America. The applicable percentages for both requirements are shown in **Table 1**. If a car met just one requirement, it was eligible for a \$3,750 credit.

EVs had to meet additional domestic requirements to qualify for the CVC. First, eligible EVs were required to undergo final assembly in North America. Second, starting in 2024, none of the battery components in credit-eligible vehicles may have been manufactured or assembled by a foreign entity of concern (FEOC) (a company significantly influenced by the government of China, Russia, Iran, or North Korea). Third, starting in 2025, none of the critical minerals in an eligible EV’s batteries may have been extracted, processed, or recycled by an FEOC. If any of these conditions were violated, vehicles became ineligible for even partial credits. **Table 1** summarizes the domestic content and manufacturing requirements in the CVC.

Table 1. Domestic Content and Manufacturing Requirements in the Clean Vehicle Credit, by Year

	North American Final Assembly	Battery Components		Critical Minerals	
		Domestic Content	FEOC Ban	Domestic Content	FEOC Ban
2023	Yes	50%	N.A.	40%	N.A.
2024	Yes	60%	Yes	50%	N.A.
2025	Yes	60%	Yes	60%	Yes
2026	Yes	70%	Yes	70%	Yes
2027	Yes	80%	Yes	80%	Yes
2028	Yes	90%	Yes	80%	Yes
2029	Yes	100%	Yes	80%	Yes
2030	Yes	100%	Yes	80%	Yes
2031	Yes	100%	Yes	80%	Yes
2032	Yes	100%	Yes	80%	Yes

Source: Internal Revenue Code §30D.

Notes: Vehicles acquired after August 16, 2022, must have undergone final assembly in North America. The domestic content requirements and FEOC bans applied based on the year a vehicle was placed in service. The domestic content requirements denote (a) the share of an EV’s battery components that must have been manufactured or assembled in North America; and (b) the share of critical minerals in the EV’s battery that must have been extracted or processed in the United States, extracted or processed in a country with which the United States has a free trade agreement, or recycled in North America. The clean vehicle credit does not apply to vehicles acquired after September 30, 2025; prior law authorized the credit through the end of 2032.

In addition, taxpayers must have had modified adjusted gross incomes at or below certain thresholds in either the

year they claimed the credit or the year before. The thresholds were \$150,000 for single individuals without dependents, \$225,000 for single individuals with children or other dependents (known as “heads of household”), and \$300,000 for married couples.

Finally, vans, SUVs, and pickup trucks with manufacturer suggested retail prices (MSRPs) above \$80,000 did not qualify for the CVC, nor did other vehicles with MSRPs above \$55,000. One rationale for such ceilings could have been to prevent high-wealth, low-income individuals (such as heirs or wealthy retirees) from claiming the credit when purchasing expensive EVs.

Businesses could also claim the CVC, but, as discussed below, they typically instead claimed the credit for qualified commercial clean vehicles (the CQCCV). The two credits could not be claimed for the same vehicle.

Leased Vehicles and the Avoidance of Clean Vehicle Credit Requirements

Businesses purchasing new EVs could choose to claim the CQCCV instead of the CVC. The CQCCV was calculated differently from the CVC, was not subject to domestic content or manufacturing requirements, and could be claimed for vehicles used in the ordinary course of business or for vehicles leased to customers.

The CQCCV could be claimed for all-electric vehicles, fuel cell vehicles, and certain plug-in hybrid electric vehicles. The credit’s value differed by vehicle type, as discussed below:

- For plug-in hybrid vehicles, the credit was equal to the incremental cost of the vehicle or 15% of the vehicle’s cost, whichever was lower.
- For all-electric and fuel cell vehicles, the credit equaled the incremental cost of the vehicle or 30% of the vehicle’s cost, whichever was lower.

A vehicle’s incremental cost was defined as the additional cost for an electric, plug-in hybrid, or fuel cell vehicle as compared with a gas- or diesel-fueled vehicle of similar size and use. Plug-in hybrid and all-electric vehicles must have had a battery capacity of at least 7 kilowatt-hours if they weighed less than 14,000 pounds and at least 15 kilowatt-hours if they weighed 14,000 pounds or more. The CQCCV could not exceed \$7,500 for a vehicle weighing less than 14,000 pounds. For vehicles weighing 14,000 pounds or more, the CQCCV could not exceed \$40,000. Certain heavy-duty vehicles ineligible for the CVC therefore qualified for the CQCCV.

The CQCCV was nonrefundable, meaning that businesses were not entitled to a refund if their tax credits exceeded their tax liabilities. However, any unused credits could (and still may) be carried forward to offset future tax liabilities. Tax-exempt organizations were eligible to receive the credit as a direct cash payment instead of as a nonrefundable tax credit. (For more information on direct cash payments, see CRS In Focus IF12596, *Tax Credit Transfers and Direct Payments in the Inflation Reduction Act of 2022*.)

The CQCCV did not have any domestic content or manufacturing requirements. Qualifying vehicles did not need to be assembled in North America, and neither their battery components nor their critical minerals needed to come from domestic sources. In addition, battery components and critical minerals could be purchased from FEOCs. Moreover, subsection (d)(1) of Internal Revenue Code (IRC) Section 45W—the section authorizing the CQCCV—states that the income and price limits from the CVC did not apply to the CQCCV.

If the CQCCV were claimed only for vehicles used in the ordinary course of business—for example, vehicles used to transport goods from one place to another—then it would not have conflicted with the requirements in the CVC. Businesses would have claimed the CQCCV, and individuals would have claimed the CVC, with the two credits having different requirements.

However, IRC §45W(c)(1) states that vehicles “acquired for use or lease by the taxpayer and not for resale” were eligible for the CQCCV. Due to the phrase “or lease,” car dealers began claiming the CQCCV for vehicles they leased, then passing some or all of the benefits to consumers through discounts or price reductions.

This tactic was applied to vehicles not eligible for the CVC. For example, Hyundai advertised lessees’ ability to receive a “\$7,500 EV Lease Bonus” for the Ioniq 5 SE Standard Range, which was not manufactured in North America. Dealers and manufacturers say they passed the credit to consumers for dozens of leased EV models, including EVs above the MSRP limits and EVs manufactured outside North America. (As of December 2023, Hyundai leased more than 40% of its EVs, up from 5% before certain domestic CVC restrictions took effect.) Finally, over half of EV drivers have incomes above \$100,000, and roughly one-third have incomes above \$200,000, suggesting that some taxpayers above the CVC income limits may have benefited from the leased vehicles exception.

The economic benefits of the leased vehicles exception were likely split between lessees, car dealers, and other businesses along the EV supply chain based on a variety of factors. For example, if a car dealer reduced the down payment on a leased EV by \$1,000 in response to the CQCCV, then the lessee gained \$1,000, while the dealer gained the remaining \$6,500. Conversely, if a car dealer lowered the down payment by \$6,500, then the lessee would have received a \$6,500 benefit, while the dealer would have received \$1,000. Insofar as the leased vehicles exception increased demand for EVs, some of the gains may have also been passed to car manufacturers or suppliers of raw EV materials. This is especially true of foreign-sourced materials that could not be included in CVC-eligible vehicles.

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