

## **Treasury Issues Proposed Regulations for CHIPS Act**

On March 21, 2023, the IRS and Treasury Department issued a notice of proposed rulemaking, (RIN 1545—BQ54) containing proposed regulations (the “Proposed Regulations”) to implement the advanced manufacturing investment credit under the CHIPS Act of 2022 (the “Chips Act”).

### **The CHIPS Act**

Section 107(a) of the CHIPS Act, enacted as Division A of Public Law 117-167, 136 Stat. 1366, 1393 (August 9, 2022), added Section 48D to the Internal Revenue Code of 1986, as amended (the “Code”) to establish an advanced manufacturing investment credit (the “Section 48D credit”) as an investment credit for purposes of Section 46 of the code, which is a current year general business credit under Section 38 of the Code.

For an eligible taxpayer in a given taxable year, the Section 48D credit is basically 25% of the basis of any qualified property that is part of the taxpayer’s advanced manufacturing facility, if the property is placed in service during the taxable year and after December 31, 2022. The credit does not apply to property the construction of which begins after December 31, 2026. For property placed in service after December 31, 2022 but the construction of which began before January 1, 2023, the credit is limited to the extent attributable to construction, reconstruction, or erection after August 9, 2022. The portion of the basis of such property that is attributable to certain “qualified rehabilitation expenditures” is excluded.

An “eligible taxpayer”, under Section 48D(c) is any taxpayer that (1) is not a “foreign entity of concern”, and (2) has not made an “applicable transaction” during the taxable year. Under Section 48D(b)(1), the “qualified investment” with respect to any advanced manufacturing facility for any taxable year is the basis of any qualified property placed in service by the taxpayer during the taxable

year which is part of an advanced facility. Under Section 48D(b)(2), “qualified property” means tangible property with respect to which depreciation (or amortization) is allowable that is integral to the operation of the advanced manufacturing facility if (1) constructed, reconstructed, or erected by the taxpayer, or (2) acquired by the taxpayer, if the original use of such property commences with the taxpayer. Qualified property includes any building or its structural components satisfying such requirements, except for the portion used for offices, administrative services, or other functions unrelated to manufacturing. Under Section 48D(b)(3), “advanced manufacturing facility” means a facility for which the primary purpose is the manufacturing of semiconductors or semiconductor manufacturing equipment. Section 48D(d)(1) allows an eligible taxpayer to elect to treat the Section 48D credit as a payment of Federal income tax. Section 48D(d)(2) provides special rules relating to this election for property held by partnerships and S corporations.

Section 107(b)(2) of the CHIPS Act added Section 50(a)(6)(D) of the Code, defining “applicable transaction” to mean, with respect to any applicable taxpayer, any significant transaction (as determined by the Secretary of the Treasury, in coordination with the Secretaries of Commerce and Defense), involving the material expansion of semiconductor manufacturing capacity of such taxpayer in a foreign country of concern (as defined in Section 9901(7) of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, as amended by Section 103 of the CHIPS Act) other than certain transactions that primarily involve the expansion of manufacturing capacity for legacy semiconductors.

### **The Proposed Regulations**

#### **The Section 48D Credit Calculation**

The Proposed Regulations apply already established credit mechanics and procedures used generally for investment tax credits, and provide rules for calculating the amount of the qualified

investment, including in the context of certain passthrough entities. The Proposed Regulations clarify, for example, that a partner's share of basis in the qualified property of a partnership is determined under the rules in Treas. Reg. 1.46-3(f), basically treating the partner as the taxpayer with respect to its share of the basis of the partnership's qualified property. With respect to S corporations, an S corporation must apportion the basis of the qualified property pro rata among its shareholders, and each shareholder is treated as the taxpayer with respect to the shareholder's share of basis in the qualified property of the S corporation. A similar rule applies to the beneficiaries of an estate or trust.

### **Qualified Property**

The Proposed Regulations clarify that human resources or personnel services, payroll services, legal and accounting services, and procurement services, sales and distribution functions, and security services (not including cybersecurity operations) are among functions "unrelated to manufacturing semiconductors or semiconductor manufacturing equipment" for purpose of the definition of "qualified property" under Section 48D(b)(2)(B)(ii).

The Proposed Regulations define "original use" generally as the first use to which property is put in connection with a trade or business for the production of income, and add some special rules for inventory.

The Proposed Regulations also clarify that to be qualified property, the property must be "integral to the operation of the advanced manufacturing facility", meaning that it is used directly in the manufacturing operation and is essential to the completeness of the manufacturing operation. Furthermore, property, including a building and its structural components, that constitutes a research or storage facility may qualify as integral to the operation of an advanced manufacturing facility if the property is used in connection with the manufacturing of semiconductors or semiconductor manufacturing equipment.

### **Advanced Manufacturing Facility**

The Proposed Regulations clarify that the determination of whether the primary purpose of a facility is or is not manufacturing finished semiconductors or manufacturing finished semiconductor manufacturing equipment will be made based on all the facts and circumstances, and lists various relevant factors. The Proposed Regulations clarify that a facility that manufactures, produces, grows, or extracts materials or chemicals that are supplied to an advanced manufacturing facility that manufactures semiconductors, or semiconductor manufacturing equipment does NOT meet the primary purpose requirement. The Proposed Regulations also provide some definitions for “semiconductor manufacturing” and “manufacturing of semiconductor manufacturing equipment”.

### **Beginning of Construction**

The Proposed Regulations clarify that a taxpayer can establish the beginning of construction of a property by meeting a “Physical Work Test” or a “Five Percent Safe Harbor”. The Proposed Regulations further clarify that for these purposes, the taxpayer must meet a “Continuity Requirement”, where the taxpayer demonstrates that either continuous construction or continuous efforts have occurred. The Proposed Regulations provide that a taxpayer is deemed to satisfy the Continuity Requirement if the property is placed in service no more than 10 calendar years after the date the Physical Work Test or the Five Percent Safe Harbor is first satisfied.

### **Recapture in the Case of Certain Expansions**

The Proposed Regulations clarify that an “applicable taxpayer” also includes (1) any member of an affiliated group that includes a taxpayer who has been allowed a credit under Section 48D(a) for any prior taxable year; (2) any taxpayer that made an election under Section 48D(d)(1); (3) any partnership or S corporation that has made an election under Section 48D(d)(2); and (4) any partner or partnership (directly or indirectly through one or more tiered partnerships) or shareholder in an S corporation for

which the entity made an election under Section 48D(d)(2) with respect to a credit under Section 48D(a)(1) for any taxable year prior to the taxable year in which the entity entered into an applicable transaction. If an applicable taxpayer engages in an applicable transaction before the close of the 10 year period beginning with when the property was placed in service, then the applicable taxpayer is subject to an increase in tax. The Proposed Regulations provide some guidance about this (basically recapturing past credits), including with respect to partners in partnerships.

#### **Possible Record Keeping and Reporting Requirements**

The Treasury Department and the IRS are considering record retention and information reporting requirements for applicable taxpayers in addition to what may already be required under current law.

#### **Applicable Date**

The Proposed Regulations are proposed to apply in final form to taxable years ending on or after the date of the Treasury Decision adopting them as final as published in the Federal Register. Taxpayer may rely on the Proposed Regulations for property placed in service after December 31, 2022, in taxable years ending before the date of such Treasury Decision.

March 28, 2023 by Kenneth Yoon

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