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KPMG report: Notable highlights from section 48D proposed regulations (advanced manufacturing investment credit)

The U.S. Treasury Department and IRS released for publication in the Federal Register proposed regulations (REG-120653-22) to implement the advanced investment tax credit (ITC) under section 48D established by H.R. 4346, “The CHIPS and Science Act of 2022,” to incentivize the manufacture of semiconductors and semiconductor manufacturing equipment within the United States. Read [TaxNewsFlash](#)

Section 48D provides a 25% ITC for an investment in an advanced manufacturing facility, defined in the statute as a facility for which the primary purpose is the manufacturing of semiconductors or semiconductor manufacturing equipment.

The [proposed regulations](#) [PDF 291 KB] (16 pages) provide clarity on key credit terms and request comments on areas in need of more industry input.

The proposed regulations are proposed to apply to tax years ending on or after the date the regulations are finalized. However, taxpayers may rely on the proposed regulations for property placed in service after December 31, 2022, provided the taxpayers follow the proposed regulations in their entirety and in a consistent manner. Comments and requests for a public hearing must be submitted by May 22, 2023.

Overview of key items from proposed regulations

Advanced manufacturing investment credit determined

In this section, IRS and Treasury provided definitions and clarity relating to the definition of qualified property for purposes of the section 48D credit. Most notably, they define the terms “semiconductor” and “semiconductor manufacturing equipment” as follows:

- **Semiconductor:** An integrated electronic device or system most commonly manufactured using materials such as, but not limited to, silicon, silicon carbide, or III-V compounds, and processes such as, but not limited to, lithography, deposition, and etching. Such devices and systems include, but are not limited to, analog and digital electronics, power electronics, and photonics, for memory, processing, sensing, actuation, and communications applications.
- **Semiconductor manufacturing equipment:** The specialized equipment integral to the manufacturing of semiconductors and subsystems that enable or are incorporated into the manufacturing equipment. The proposed regulations then go on to provide a list of examples of qualified semiconductor manufacturing equipment.

This section also addresses the allocation of the eligible basis, for partnerships and s corporations, for the purposes of determining the credit. This was not clear in the statute, but the proposed regulations clarify that partners are treated as the taxpayer with respect to its share of the basis and the basis is generally determined in accordance with the ratio in which the partners divide general profits of the partnership. S corporations must apportion the basis pro rata among its shareholders. This is consistent with the rules in §1.46-3(f).

KPMG observation

This section provides clarity on what the IRS and Treasury would qualify as a semiconductor under the proposed regulations. Notably a semiconductor is defined narrowly to exclude various components of semiconductors. Treasury and the IRS are seeking public input and ask that taxpayers submit specific comments regarding why certain components should be included in the definition. This may be signal that IRS and Treasury are willing to provide an expanded definition of semiconductors in the final regulations, provided they can find a way to do so without expanding the definition to include an overly broad category of components.

Qualified property

In this section the proposed guidance more clearly defines the types of assets that would be considered qualified property and, thus, included in the basis of the project for the purposes of calculating the ITC.

Most notably, the proposed regulations provide exceptions to qualified property, including tangible depreciable property used for offices, administrative services such as human resources or personnel services, payroll services, legal and accounting services, procurement services, sales or distribution functions, security services (not including cybersecurity operations), or any other functions unrelated to the manufacturing of semiconductors or semiconductor manufacturing equipment.

IRS and Treasury’s also define what is considered “integral to the operation of an advanced manufacturing facility,” meaning property that is used directly in the manufacturing operation, is essential to the completeness of the manufacturing operation, and is not transformed in any material way as a result of the manufacturing operation. The proposed regulations go on to provide examples of property that is considered integral to the operation of an advanced manufacturing facility, including Chemical Vapor Deposition (CVD), Physical Vapor Deposition (PVD), Etching equipment, lithography equipment including Extreme Ultraviolet Lithography (EUV), wet process tools, inspection and metrology equipment, clean rooms, specialized handling equipment, power facilities and other utilities, and research and storage facilities (unless the research facility does not manufacture semiconductors or semiconductor manufacturing equipment).

KPMG observation

The definitions provided in this section align closely with definitions provided in guidance regarding

the section 48 investment tax credit (§ 1.48-1), for the purposes of determining ITC-eligible property. The proposed regulations provide for an extensive, but not exhaustive, list of property that can be treated as either ITC-eligible or excluded for the purposes of calculating the credit. So, we anticipate that there will still be certain assets and taxpayer fact patterns that fall into grey areas that require further clarification and analysis to determine whether the asset should be treated as qualified property.

Advanced manufacturing facility of an eligible taxpayer

This section of the proposed regulations provides definitions related to the advanced manufacturing facilities of eligible taxpayers. In some cases, these definitions further solidify the definitions provided earlier in the proposed regulations. In particular, IRS and Treasury define the “primary purpose” of an advanced manufacturing facility to be that the facility is designed to make finished semiconductors or finished products consisting of specialized equipment that can only be used for semiconductor manufacturing, and provides that facilities that produce components, e.g., grow wafers, are not facilities for which the primary purpose is the manufacturing of semiconductors. Further, the proposed regulations state that the possession of permits or licenses to manufacture finished semiconductors or finished semiconductor manufacturing equipment must be in place either before or within 6 months after the facility is placed in service. This clarifies that, under the current drafting of the proposed regulations, the only qualified facilities are those that are producing *finished* semiconductors, which provides a clearer picture of the intent of the activities that the IRS and Treasury are trying to incentivize with this credit.

And relevant to manufacturing facilities who are not solely dedicated to the manufacture of semiconductors or semiconductor manufacturing equipment, one of the examples explains a fact pattern under which a manufacturing facility is 75% dedicated to manufacturing semiconductor manufacturing equipment and therefore meets the “primary purpose” test.

KPMG observation

Based on these definitions, taxpayers seeking an expanded definition of semiconductor should also consider the definition of the primary purpose of an advanced manufacturing facility. Also, note that while 75% is provided in an example as meeting primary purpose, the proposed regulations do not provide a 75% test as part of the rules of this section. Taxpayers may need additional clarity on this point.

Beginning of construction

In this section, IRS and Treasury provided guidance regarding the beginning of construction requirement for purposes of the 48D credit effective dates. The credit allowed under section 48D does not apply to property that is part of an advanced manufacturing facility if the beginning of construction begins after December 31, 2026.

The proposed regulations for the beginning of construction rules largely leverage prior issued guidance (IRS Notice 2013-29) to determine when a taxpayer has “begun construction.” Specifically, the proposed regulations state that a taxpayer may establish that construction of an item of property of the taxpayer begins under either the physical work test, or the five percent safe harbor test.

With respect to the continuity requirement, the proposed regulations maintained the same principles, and have provided that continuity will be deemed satisfied if the taxpayer places the facility in service within 10 years of the beginning of construction. The preamble provides that 10 years is appropriate given the critical national security and foreign policies of the United States that the section 48D credit is intended to achieve.

Another notable item in this section of the proposed regulations is the definition of a single advanced manufacturing facility project for the purposes of determining the beginning of construction. This was defined for taxpayers who have multiple items of qualified property or advanced manufacturing facilities that are operated as part of a single advanced manufacturing project. The proposed regulations state

that those properties that are operated as part of a single advanced manufacturing facility project will be treated as a single item of qualified property for the purposes of determining beginning of construction.

This section goes on further to define certain factors that will be used to determine whether facilities should be treated as a single advanced manufacturing facility. This list includes common legal ownership, properties that are constructed on a contiguous piece of land, properties that are described in a common contract, properties that share common electricity and/or water supply, properties described in common environmental or regulatory permits, properties constructed pursuant to a single master construction contract, or properties financed pursuant to the same loan agreement or financing arrangement.

KPMG observation

The concept of treating multiple items of qualified property or advanced manufacturing facilities that are operated as part of a single advanced manufacturing project as one facility for the purposes of determining when construction begins is interesting and impactful for taxpayers that are currently planning facilities that will be executed in different phases.

The list of factors that determine whether multiple items of qualified property will be treated as one facility will impact how taxpayers will plan the construction, financing, facility operations, and legal ownership of advanced manufacturing facilities. It will also impact the way taxpayers execute contracts for the purposes of attaining the effective dates.

Elective payment election

Section 48D(d) provides that, in the case of a taxpayer making an election, the taxpayer shall be treated as making a payment against the tax imposed equal to the amount of such credit, making this effectively a refundable tax credit.

KPMG observation

Although the proposed regulations do not provide any new guidance with respect to the elective payment election, it does state that the IRS intends to provide, through forms and instructions, the procedures for registration of properties for which an election under section 48D(d) will be made. This is another area where the IRS and Treasury requested feedback from taxpayers regarding the registration requirements and other procedures for the election.

Recapture of the advanced manufacturing ITC for certain expansions

Lastly, the proposed regulations clarify how the government could reclaim the credit from “applicable taxpayers” under a special 10-year credit recapture rule if they engage in a significant transaction involving the material expansion of semiconductor manufacturing capacity in a foreign country of concern.

The proposed regulations define “applicable taxpayer” to include the taxpayer is who is allowed the section 48D credit as well as member of affiliated groups and partnerships and S corps who have made a direct pay election.

These proposed regulations define the term “significant transaction” to mean a transaction whose value exceeds \$100,000, or series of transactions which in the aggregate during the applicable term of a required agreement are valued at \$100,000 or more. This monetary value was chosen in order to provide a clear and quantitative standard that captures even modest expansions by funding recipients of semiconductor manufacturing capacity in foreign countries of concern.

The term “material expansion” is defined in the proposed regulations to include the construction of new facilities and the addition of new semiconductor manufacturing capacity and uses a quantitative measure of 5% of existing capacity to provide clear and predictable scoping. This definition is meant to

allow for funding recipients that have existing facilities in a foreign country of concern to continue to operate and maintain their competitiveness by allowing for technological upgrades, as long as overall semiconductor manufacturing capacity is not increased by more than 5%.

For the taxable year in which these transactions occur the taxpayer's federal income tax liability must be increased by 100% of the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from reducing to zero any investment credit determined under section 46 that is attributable to the section 48D credit with respect to such property. In other words, if a taxpayer engages in an applicable transaction during the 10-year recapture period, 100% of their credit will be recaptured.

Additionally, the IRS and Treasury are considering information reporting requirements that would require notifying the IRS regarding any planned significant transactions of the applicable taxpayer involving the material expansion of semiconductor manufacturing capacity in a foreign country of concern, including any transaction the applicable taxpayer considers to be eligible for an exception under section 50(a)(3) or proposed §1.50-2.

KPMG observation

Based on the definitions provided in this section, taxpayers will need to be aware of all global investments within an affiliated group as to not jeopardize any credits claimed by a member of the group. Taxpayers will also need to stay aware of the potential reporting requirements in the event that IRS and Treasury require taxpayers to document and report planned significant transactions, as this could become burdensome for the taxpayer if applied retroactively.

Conclusion

This guidance, while not final, does provide some clarity for taxpayers with respect to the definition of key terms, and how those definitions will impact the planning and design of semiconductor and semiconductor manufacturing equipment facilities. The guidance also leaves open some terms and issues and will likely result robust feedback from some portions of the industry. The comments submitted in response to these proposed regulations and the impact they may have on eventual final regulations will be closely watched.

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