KPMG report: Proposed regulations on prevailing wage and apprenticeship requirements under clean energy tax incentives

September 8, 2023

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The U.S. Treasury Department and IRS on August 29, 2023, released proposed regulations (REG-100908-23) regarding the rules relating to qualifying for increased credit or deduction amounts available for taxpayers satisfying prevailing wage and registered apprenticeship (PWA) requirements established by H.R. 5376 (commonly called the "Inflation Reduction Act of 2022" (IRA)).

The IRA provides increased credit or deduction amounts that generally apply for taxpayers who satisfy certain PWA requirements regarding the construction, installation, alteration or repair of a qualified facility, qualified property, qualified project, qualified equipment or for certain energy facilities. The increased credit or deduction amount is generally equal to the base amount multiplied by five if the taxpayer satisfies the PWA requirements.

The PWA rules apply to following tax credits: Sections 30C, 45, 45Q, 45V, 45Y, 48, 48C, and 48E. The PWA rules also apply to the deduction for energy efficient commercial building property under section 179D. For the credits available under sections 45L and 45U the apprenticeship rules do not apply, only the prevailing wage rules apply.

There are two exceptions to the PWA requirements. First, if a project begins construction prior to January 29, 2023, it is deemed to have satisfied the PWA requirements and is eligible for the higher incentive rate (the "BOC exception"). Second, if a project is under one megawatt (1 MW), it also deemed to have satisfied the PWA requirements and is eligible for the higher rate (the "1 MW exception").

The proposed regulations are proposed to apply to facilities placed in service in taxable years ending after, and beginning construction after, the date the final regulations are published in the Federal Register.

Treasury and the IRS previously provided guidance on the PWA requirements in Notice 2022-61 (read *TaxNewsFlash*).

Prevailing wage requirements

Application of Davis Bacon Act

The IRA references the Davis Bacon Act in implementing the prevailing wage rules to the tax credits. The Davis Bacon Act, enacted in 1931, generally requires that laborers and mechanics working on projects pursuant to contracts with the Federal Government are paid prevailing wages. Prevailing rates are those rates most recently determined by the Secretary of Labor in accordance with the Davis Bacon Act.

The preamble to the proposed regulations discusses the extent to which the Davis Bacon Act has or has not been incorporated in the proposed regulations. In general, the proposed regulations incorporate Davis Bacon wage determinations and some relevant definitions, while certain Davis Bacon specific exceptions and penalties are not incorporated into the proposed regulations.

Definitions and scope of requirements

The proposed regulations offer definitions for various terms relevant to the PWA rules. Of note, the proposed regulations define "construction, alteration or repair" as not including work that is ordinary and regular in nature that is designed to maintain and preserve existing functionality of a facility after it is placed in service. This work includes basic inspections, cleaning and janitorial work, replacing filters and light bulbs, and equipment calibration.

KPMG observation

Additional definitional guidance on "construction, alteration or repair" is helpful but further guidance

may be needed for certain situations. For instance, in some industries facilities periodically require extensive maintenance performed during scheduled turnarounds. The proposed rule and examples provided do not appear to contemplate maintenance of that nature.

The proposed regulations also define the "geographic areas" to which the PWA requirements. Under the proposed regulations the PWA requirements apply to the locality of primary construction site of the facility as well as secondary construction sites. Support sites, such as job headquarters, tool yards and batch plants are included in the primary construction site. A secondary construction site is a site that is dedicated for a period of time to making a significant portion of an individual project.

Wage determinations

To satisfy the prevailing wage requirements, taxpayers must ensure that laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction, alteration, or repair of a facility are paid wages at rates not less than those set forth in the applicable general wage determination(s) published by the U.S. Department of Labor. The applicable general wage determination is the wage determination in effect for the specified type of construction in the geographic area when the construction, alteration, or repair of the facility begins. The wage determinations are published here: SAM.gov | Wage Determinations.

Supplemental wage determinations

The proposed regulations state that in the event a wage determination for a type of labor in a geographic area has not been published a taxpayer, contractor, or subcontractor may request a determination from the Department of Labor. The request is made by email to the following address: IRAprevailingwage@dol.gov. A request should be made no more than 90 days before the beginning of the construction, alteration, or repair. The following information is required to make the request:

- The name of the taxpayer, contractor, or subcontractor requesting the supplemental wage determination or wage rate
- The general wage determination(s), if any, applicable to construction, alteration, or repair of the facility
- A description of the work to be performed, including the type(s) of construction involved and, if the project involves multiple types of construction, information indicating the expected cost breakdown by type of construction
- The geographic area in which the facility is being constructed, altered, or repaired, including the name and address of the facility (if known)
- The start date of construction, alteration, or repair at the facility
- The labor classification(s) needed for performance of the work on the facility (excluding those for which wage rates are available on an applicable general wage determination)
- The duties to be performed by each such labor classification on the facility
- The proposed wage rate, including any bona fide fringe benefits, for each such labor classification
- Any pertinent wage payment information that may be available
- Any additional relevant information otherwise required by forms and instructions published by the U.S. Department of Labor
- Any additional information the taxpayer wants the U.S. Department of Labor to consider

For projects located offshore, instead of requesting a supplemental wage determination, a taxpayer, contractor, or subcontractor may rely on the general wage determinations applicable in geographic area located closest to the area in which the project will be located.

Timing of wage determinations

The proposed regulations state that prevailing wages applicable to a project are those in effect at the time construction, alteration or repair begins and generally remain applicable for the duration of the work. A new

wage determination would be required to be used in circumstances where work on a facility is changed to include work that was not included in the original scope.

Payment of wages

The proposed regulations provide that all laborers and mechanics would need to be paid in a time and manner consistent with the regular payroll practices of the taxpayer, contractor, or subcontractor, as applicable.

KPMG observation

The Davis Bacon Act requires weekly payment. The proposed regulations do not, however, require that laborers and mechanics are paid weekly to be in compliance with the rules, rather regular payroll practices can apply. This will be a welcome clarification to many taxpayers, contractors and subcontractors who do not pay workers weekly and would have to make significant operational changes in order to do so.

Apprenticeship wages

The proposed regulations allow payment of wages lower than the applicable prevailing wage when apprentices are participating in a registered apprenticeship program.

Apprentices must be paid bona fide fringe benefits in accordance with the requirements of the applicable apprenticeship program. If the apprenticeship program does not provide for the payment of fringe benefits, apprentices must be paid the full amount of fringe benefits as listed with the applicable wage determination. The IRA provides that to satisfy the apprenticeship component of the PWA requirements, the applicable percentage of labor hours that must be performed by qualified apprentices is 12.5% for projects which begin construction during 2023 and 15% for projects which begin construction after 2023. The proposed regulations state that any apprentice performing work on the job site in excess of the relevant ratio must be paid not less than the applicable wage rate.

Curing a failure to satisfy prevailing wage requirements

The relevant IRA statutory provisions state that a failure to meet prevailing wage requirements can be cured by the taxpayer paying:

- The worker the difference between what was actually paid and the prevailing wage (three times the amount of the shortfall in the case of intentional disregard)
- Interest on the shortfall (the rate is the federal short-term rate plus 6%)
- Penalty of $5,000 per each laborer and mechanic that was not paid a prevailing wage ($10,000 in the case of intentional disregard)

The proposed regulations provide that the obligation to make the corrective and penalty payments arises at the time the credit is claimed on the taxpayer's return, meaning that an instance of noncompliance will not make the taxpayer ineligible for the increased credit as long as the corrective and penalty payments are made by the time the credit is claimed on the taxpayer's return. The preamble to the proposed regulations states that the earliest a penalty payment can be made is at the time the return is filed claiming the credit, but corrective payments can be made at any time.

The proposed regulations provide that in the case of a transfer of credit under section 6418, it is the transferor taxpayer who is obligated to make the correction and penalty payments. In these cases, the obligation to be in compliance with the PWA rules becomes binding upon the earlier of the filing of the transferor taxpayer's return for the year in which the credit is determined, or the filing of the return of the transferee taxpayer for the year in which the credit is taken into account.

As noted, the $5,000 per laborer penalty is increased to $10,000 per laborer in the case of intentional regard. The proposed regulations offer additional guidance on the determination of when the failure to pay prevailing wages is due to intentional disregard. In particular, the proposed regulations state that when a failure to pay is "knowing or willful."

The proposed regulations offer examples of facts and circumstances that are considered in determining intentional disregard. These examples include, for instance, whether there has been a pattern of failure to pay, whether the taxpayer takes steps to determine applicable classifications and wage rates, whether prior failures have been cured promptly, whether the taxpayer reviewed payment records at least quarterly, whether contract terms required compliance, whether the taxpayer posted the applicable wage rates, and whether the taxpayer had procedures in place for reporting failures. In addition, if a taxpayer makes corrective and penalty payments it is presumed to not have disregarded the requirements.

Finally, the proposed regulations describe that the penalty can be waived when the worker was working under certain pre-hire collective bargaining agreement and the correction payment is made before the taxpayer claims the credit on it return. The penalty can also be waived by making corrective payments by the earlier of 30 days of when the taxpayer became aware of the error or the date the credit is claimed on the return, but only if either: 1) the worker was not underpaid in more than 10% of all pay periods during the year that he or she was employed on the project, or 2) the shortfall was not more than 2.5% of what he or she should have been paid during the year.

Apprenticeship requirements

Labor hours requirement

A taxpayer claiming or transferring the increased credit amount must satisfy three elements to meet the apprenticeship requirement: labor hours, apprentice-to-journeyworker ratios, and participation by apprentices.

First, regarding the labor hour requirement, a taxpayer must ensure that a certain percentage of total labor hours devoted to the construction, alteration, or repair work of a qualified facility is performed by a qualified apprentice. The percentage of labor hours begins at 10% for facilities that begin construction before 2023 and increases to 12.5% for facilities that begin construction in 2023 and 15% for facilities that begin construction in 2024 and beyond. A qualified apprentice is an individual who is employed by the taxpayer, a contractor, or subcontractor and who is participating in a registered apprenticeship program.

Second, with respect to the apprenticeship-to-journeyworker ratio, taxpayers must follow any requirements of the US Department of Labor or applicable state apprenticeship agency, including any apprentices-to-journeyworker requirements.

Third, there is a participation requirement requiring each taxpayer, contractor, or subcontractor who employs four or more individuals with respect to the construction of a facility to employ one or more qualified apprentices.

KPMG observation

It is not clear from the proposed regulations whether these requirements extend to the alteration or repair of a qualified facility. For example, the labor hour requirement includes labor hours devoted to the "construction, alteration, or repair." Example 1 in paragraph (e)(2)(i)(D) seems to support a view that the labor hour requirement includes all labor hours spent on "construction, alteration, or repair" from the beginning of construction through the tax return filing.

Good faith effort exception

There are four exceptions to the apprenticeship requirements: the good faith effort exception, the cure provision, the 1 MW exception, and the beginning of construction exception.

First, under the good faith effort exception, the taxpayer is deemed to have satisfied the apprenticeship requirements if it has requested qualified apprentices from a registered apprenticeship program and (i) the request is denied (provided the denial is not based on the taxpayer, contractor, or subcontractor's refusal to comply with the standards and requirements of the registered apprenticeship program), or (ii) the registered apprenticeship program fails to respond within five business days.

Notably, the proposed regulations provide that, to qualify for the good faith effort exception, a written request for qualified apprentices must be sent to at least one registered apprenticeship program that (i) operates in the geographic area of the facility or that can reasonably be expected to provide apprentices to the location of the facility, (ii) trains apprentices in the occupation(s) needed to perform construction, alteration, or repair with respect to the facility, and (iii) has a usual and customary business practice of entering into agreements with employers for the placement of apprentices in the occupation for which they are training. If the request is denied or not responded to, however, the taxpayer must submit an addition request every 120 days. Further, an automatically generated e-mail is a considered a response from the registered apprenticeship program.

KPMG observation

The proposed regulations seem to take a narrow view on what will meet the good faith effort exception. In particular, it is a high hurdle to require additional requests to be made every 120 days in the event an initial request for qualified apprentices is denied.

Second, pursuant to the apprenticeship cure provision, the taxpayer may make a penalty payment to the IRS of $50 multiplied by the total labor hours for which the labor hours requirement or the participation requirement was not satisfied. The penalty increases if the failure was due to intentional disregard. International disregard is determined based on the facts and circumstances, with factors such as a pattern of conduct, steps taken to determine the percentage of labor hours required, and contract provisions considered. If a taxpayer makes a penalty payment before receiving notice of an examination from the IRS, the taxpayer will be presumed not to have intentionally disregarded the apprenticeship requirements.

A helpful safe harbor is provided, such that a penalty payment is not required for failing to meet the labor hours requirement or the participation requirement if the construction, alteration, or repair work of a qualified facility is done pursuant to a qualifying project labor agreement.

If an increased credit is transferred, the obligation to make any penalty payment remains with the transferor of the credit. If the transferor does not make any required penalty payments, the transferee's credit will be reduced to the base credit amount.

Third, there is an exception for a facility that has a maximum net output of less than 1 MW based on nameplate capacity.

Finally, there is an exception for a facility which began construction prior to January 29, 2023.

Recordkeeping

The taxpayer must maintain records sufficient to establish that the prevailing wage and apprenticeship requirements have been satisfied. The taxpayer's burden is as prescribed under section 6001 and the regulations thereunder.

In the case of a taxpayer that is acquiring a credit under section 6418, the requirement to maintain and preserve sufficient records demonstrating compliance with the applicable prevailing wage and apprenticeship requirements remains with the "eligible taxpayer" that determined and transferred the credit–in other words, the seller of the credit.

KPMG observation

In the case of a transfer of the credit, the proposed regulations appear to bifurcate the underpayment liability (e.g., owed by the buyer of the credit) from the person able to provide the requisite documentation supporting the credit. In other words, if the buyer of the credit is audited and there is not sufficient documentation available to substantiate that the bonus rate is available, only the seller of the credit can remedy the documentation deficiency and/or pay back wages and the applicable penalties. Buyers of credits will want to make sure they have adequate indemnities and/or tax insurance to protect against unexpected underpayment liabilities.

For each qualified facility for which a taxpayer claiming or transferring an increased credit, the taxpayer must maintain and preserve records sufficient to demonstrate compliance with the prevailing wage and apprenticeship requirements.

At a minimum, those records include payroll records for each laborer and mechanic (including each qualified apprentice) employed by the taxpayer, contractor or subcontractor in the construction, alteration or repair of the qualified facility.

In addition to payroll records, records sufficient to demonstrate compliance with the applicable prevailing wage requirements may include the following information for each laborer and mechanic (including each qualified apprentice) employed by the taxpayer, a contractor or subcontractor with respect to each qualified facility:

- Identifying information, including the name, social security or tax identification number, address, telephone number, and email address
- The location and type of qualified facility
- The labor classification(s) the taxpayer applied to the laborer or mechanic for determining the prevailing wage rate and documentation supporting the applicable classification, including the applicable wage determination
- The hourly rate(s) of wages paid (including the rate to contributions or costs for bona fide fringe benefits or cash equivalents thereof) for each applicable labor classification
- Records to support any contribution irrevocably made on behalf of a laborer or mechanic to a trustee or other third person pursuant to a bona fide fringe benefit program, and the rate of costs that were reasonably anticipated in providing bona fide fringe benefits to laborers and mechanics pursuant to an enforceable commitment to carry out a plan or program described in 40 USC 3141(2)(B), including records demonstrating that the enforceable commitment was provided in writing to the laborers and mechanics affected
- The total number of labor hours worked per pay period
- The total wages paid for each pay period (including identifying any deductions from wages)

- Records to support wages paid to any apprentices at less than the applicable prevailing wage rates, including records reflecting the registration of the apprentices with a registered apprenticeship program and the applicable wage rates and apprentice to journeyworker ratios preset by the apprenticeship program
- The amount and timing of any correction payments and documentation reflecting the calculation of the correction payments

Records sufficient to demonstrate compliance with the apprenticeship requirements may include the following information for each apprentice employed by the taxpayer, a contractor or subcontractor with respect to each qualified facility:

- Any written requests for the employment of apprentices from registered apprenticeship programs, including any contacts with the US Dept. of Labor's Office of Apprenticeship or a State apprenticeship agency regarding request for apprentices from registered apprenticeship programs
- Any agreements entered into with registered apprenticeship programs with respect to the construction, alteration or repair of the facility
- Documents reflecting the standards and requirements of any registered apprenticeship program, including the applicable ratio requirement prescribed by each registered apprenticeship program from which taxpayers, contractors, or subcontractors employ apprentices
- The total number of labor hours worked by apprentices
- Records reflecting the daily ratio of apprentices to journeyworks

Conclusion and next steps

On the whole the proposed regulations did not contain big surprises or deviations from the previous guidance. And the clarifications provided will likely help taxpayers as the begin to or continue to navigate various labor and documentation requirements, which many have never had to manage before, but which are critical so realizing the full potential benefits of the relevant tax incentives.

The comment process is now underway for these proposed regulations and the implementation process for the final regulations will certainly be closely monitored by participants in this space. Comments on the proposed regulations are due by October 30, 2023.

Contact us

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