



# CHIPS Act tax credit—direct pay final regulations

March 19, 2024

The U.S. Treasury Department and IRS issued final regulations related to the direct payment (formally known as “elective payment,” but more commonly referred to as “direct payment”) of the section 48D advanced manufacturing investment tax credit enacted in the “The CHIPS and Science Act of 2022” (CHIPS Act). These regulations respond to comments submitted by taxpayers, and describe the rules for making the election, special rules applicable to partnership and S corporations, penalties for excessive payments, basis reductions and recapture, denial of double benefit, and the pre-filing registration process. Read [TaxNewsFlash](#)

The final regulations are effective beginning May 10, 2024.

## Background

Section 48D provides a 25% investment tax credit (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.

Section 48D allows taxpayers to elect to treat the amount of the section 48D credit determined under section 48D(a) as a payment against tax.

Proposed section 48D regulations relating to definitional and eligibility issues were issued in March 2023 (read [TaxNewsFlash](#)). Proposed and temporary section 48D regulations relating to direct payments were issued (along with similar rules for certain Inflation Reduction Act (IRA) tax credits) in June 2023. Read [TaxNewsFlash](#)

These final regulations are largely consistent with the June 2023 proposed and temporary regulations, but with some clarifications and changes in response to comments received. Notable updates and deviations from the proposed regulations are described in more detail below in this report.

## Final regulations

### Pre-registration

The proposed regulations provided that a taxpayer must obtain a registration number for each “qualified investment” in an advanced manufacturing facility with respect to which a direct payment election is made.



Section 48D(a) provides that the section 48D credit for any tax year is an amount equal to 25% of the “qualified investment” for such tax year. Section 48D(b) generally provides that the “qualified investment” with respect to any advanced manufacturing facility for any tax year is the basis of any qualified property placed in service by the taxpayer during such tax year which is part of an advanced manufacturing facility. Qualified property is generally defined in 48D as the depreciable property that is integral to the operation of the advanced manufacturing facility.

Commenters asked for clarifications on these points and some commenters requested that registrations should be able made at the overall facility level.

The final regulations adopt the proposed rules and note that the rule allows for flexibility depending on what a taxpayer’s qualified investment in any given year may be, but state that a blanket facility level registration is not workable. The final regulations also provide guidance on the types of any additional information that may support a pre-registration, including:

- The type of qualified investment
- Physical location
- Supporting documentation such as state and local government permits to operate the advanced manufacturing facility, certifications, and evidence of ownership
- The beginning of construction date and the placed in service date of any qualified property that is part of the advanced manufacturing facility
- The source of funds the taxpayer used to acquire the qualified property
- Any other information that the taxpayer or entity believes will help the IRS evaluate the registration request

### **KPMG observation**

Questions around the granularity of the section 48D pre-registration have been circulating since the issuance of the proposed regulations and the opening of the pre-registration portal so it is helpful that the final regulations confirm that the registration is based on the qualified investment. However, questions may remain about the mechanics of the registration. Despite the statutory language and proposed and now final regulations, the pre-registration portal appears to assume that the registrations will be made on a facility level and does not seem to account for how a qualified investment for any year may include dozens or more items of qualified property.

There is also no “bulk upload” option for section 48D pre-registration in the portal. The final regulations acknowledge this and state in the preamble that documentation to support the existence of a valid qualified investment will vary by the property and a registrant does not need to provide all information that may be available. The preamble further notes that to the extent the information provided is insufficient for purposes of the pre-filing registration process, the IRS may request further information.

## **Making the election**

The direct pay election is made on a taxpayer’s original return (including a superseding return) filed not later than the due date, including extensions, for tax year in which the credit is determined.

In response to comments, the final regulations clarify the treatment of certain situations with superseding returns, acknowledging that some taxpayers may seek to expedite a payment of a refund by making a direct pay election on an earlier filed return and then filing superseding return later containing more complete tax year information. The final regulations generally indicate that if the superseding return results in increased direct pay amount, the election is treated as made on the superseding return. If the superseding return results in a reduced amount, the taxpayer could be subject to interest and penalties if the taxpayer fails to



pay the difference with the superseding return. If the superseding return results in no change to the direct payment amount, the election is treated as made on the originally filed return.

The final regulations also clarify that the amount of a credit may be adjusted on an amended return or an administrative adjustment request (AAR). This clarification is intended to address situations in which a taxpayer actually made a direct payment election on a timely filed return but made a reporting error with respect to an element of the valid election (for example, miscalculating the amount of the credit on the original return or making a typographical error in the process of inputting a registration number). This would allow the taxpayer to correct errors or to correct an excessive payment before an excessive payment determination is made by the IRS. Additionally, it is permissible for taxpayers to correct errors that would increase the amount claimed as long as the larger amount claimed on the amended return or AAR is accurate.

To properly correct an error on an amended return or AAR, a taxpayer must have made an error in the information included on the original return such that there is a substantive item to correct. For instance, the regulations provide that a taxpayer cannot correct a blank item or an item that is described as being “available upon request.”

For taxpayers that failed to make a timely direct pay election on their originally filed return (filed by the due date, without extensions), the final regulations also modify the proposed regulations to permit a six-month extension of time from the due date of the return (excluding extensions) to make the election, provided the taxpayer follows the procedures in Treas. Reg. 301.9100-2.

## General business credit rules—estimated taxes, BEAT and denial of double benefit

The proposed regulations provided that if a taxpayer intends to make a direct pay election, that credit cannot be included in estimating the taxpayer’s quarterly estimated tax payments. The final regulations provide that taxpayer may include credits that are eligible for the direct pay election in their estimated tax payments, but only to the extent that the amount of those credits does not exceed their general business credit (GBC) limitation.

One commenter urged that the final regulations treat the entire direct payment amount as a payment against tax for purposes of determining base erosion minimum tax (known as the base erosion anti-abuse tax (BEAT)). The final regulations do not adopt this request, noting that section 48D(d)(3) provides that the section 48D credit to be treated as a credit for any other purposes under the Code.

And notably, in response to the proposed regulations, commenters had raised concerns about the proposed treatment of direct pay credits first as general business credits (GBCs) applied against tax pursuant to the GBC ordering rules. The concern raised related to scenarios in which taxpayers would have to apply direct pay credits ahead of other nonrefundable GBCs later in the ordering rules, potentially resulting in no net direct pay amount (i.e., the amount of 48D credit that is in excess of federal tax liability, including the GBC limitation). This scenario was particularly relevant under 48D because investment tax credits are used first under the GBC ordering rules. The final regulations change the proposed regulations such that taxpayers will calculate the net direct payment amount prior to applying the ordering rules of section 38(d).

## Timing of payment

Treasury and the IRS declined to specify a particular time within which a direct pay election will be processed, stating several factors that they anticipate will affect processing time. Additionally, commenters asked for a process whereby taxpayers could receive their refunds in the form of a prepayment, or on a quarterly basis to assist in the funding of the energy properties. Treasury and the IRS declined to provide such a rule.



However, as the preamble to the proposed and temporary regulations stated, the prefilling registration is intended to allow the IRS to verify certain information about a taxpayer in a timely manner while mitigating the risk of fraud or improper payments and then process the annual tax return with minimal delays. Therefore, the registration process is meant as an aid to speed up the processing time for payments after filing.

## Partnerships and S corporations

For elective taxpayers that are partnerships or S corporations, the proposed regulations followed the statute, providing that the direct pay election could be made only at the partnership level.

The final regulations generally follow the proposed regulations to provide that if a partnership or S corporation makes a direct payment election, any amount received is treated as tax-exempt income and each partner's share of that tax-exempt income is equal to the partner's share of the credit it would have otherwise received if the direct pay election was not made in accordance with section 704(b) regulations and 1.46-3(f) for allocations of investment tax credits (i.e., in accordance with general profits). Further, tax-exempt income is treated as received or accrued, including for purposes of sections 705 and 1366, as of the date the credit is determined (when the qualified investment is placed in service).

Commenters had requested that the final regulations allow a partnership to determine a partner's distributive share of section 48D credit without regard to 1.46-3(f). The preamble noted that Treasury and the IRS are aware that taxpayers may have entered into partnership agreements prior to the enactment of the CHIPS Act or prior to the publication of the proposed regulations and may have made assumptions regarding allocations that are inconsistent with section 48D and the proposed regulations. In response, the final regulations provide that if a partnership agreement was entered into after December 31, 2021, and before June 22, 2023, and if the partnership was formed for the purpose of owning and operating an advanced manufacturing facility, a partner's distributive share of the tax exempt income may be determined in accordance with the basic principles for partnership income allocations as described in § 1.704-1(b)(1)(i), instead of under §§ 1.704-1(b)(4)(ii) and 1.46-3(f).

## Excessive payments

Under section 48D(d)(2)(F), if the Secretary determines an amount of direct payment constitutes an excessive payment, the tax imposed on the taxpayer is made is increased by an amount equal to the sum of (1) the amount of any payment constituting an excessive payment, (2) plus 20% of such excessive payment. The increase equal to 20% of the excessive payment does not apply if the taxpayer demonstrates to the satisfaction of the Secretary that the excessive payment resulted from reasonable cause.

The proposed regulations did not provide additional guidance on what factors may contribute to the determination that there is reasonable cause. Commenters requested clarity here, in particular confirmation that it is a facts and circumstances determination and illustrative examples.

The final regulations do not offer additional guidance on reasonable cause or examples; however, the preamble confirms that existing reasonable cause standards in the Internal Revenue Code, which are fact specific, will inform these determinations.

## Conclusion

Treasury and the IRS took careful and thorough consideration of numerous comments in the drafting of the final regulations, and the guidance provided will certainly be helpful to taxpayers going forward. Now the remaining unfinished piece of section 48D implementation are the definitional and eligibility final regulations, which stakeholders are eagerly anticipating.



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