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TaxNewsFlash

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KPMG report: Overview of investment tax credit for investments in semiconductor manufacturing

President Biden today signed into law H.R. 4346, “The CHIPS and Science Act of 2022.” The date of enactment is August 9, 2022. Read ***TaxNewsFlash***

Division A of the legislation (the division referred to as the “CHIPS Act”) includes a 25% advanced investment tax credit (ITC) under section 48D for certain investments in semiconductor manufacturing.

Overview of the investment tax credit (ITC)

Section 48D provides a one-time ITC equal to 25% of the qualified investment placed in service during the tax year.

For purposes of section 48D:

- The qualified investment is the basis of any qualified property placed in service during such tax year which is part of an advanced manufacturing facility.

- An advanced manufacturing facility is defined as a facility for which the primary purpose is the manufacturing of semiconductors or semiconductor manufacturing equipment.

- Qualified property is tangible property with respect to which depreciation (or amortization in lieu of depreciation) is allowable which is: (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. Such qualified property has to be integral to the operation of the advanced manufacturing facility. Qualified property includes buildings and structural components, except for portions of buildings used for offices or other non-manufacturing purposes.

- The basis of the qualified property is reduced by an amount equal to the credit received in the year the qualified property is placed in service.

- The credit can be recaptured if a taxpayer who claimed the credit invests in a semiconductor manufacturing facility in the People's Republic of China or a "foreign country of concern" during the 10-year period starting with the date the credit eligible property is placed in service.

- Taxpayers may treat the credit as a payment of tax under a "direct pay" election, under which the payment of tax is applied against taxable income, if any, and the excess is paid as a refund. In the case of partnerships, the election is made and the refund is paid at the partnership level. Taxpayers can make the election no earlier than 270 days after the date of enactment (August 9, 2022).

- Finally, the effective date of the ITC measure provides that qualifying property that is placed in service after 2022 and that began construction prior to 2027 is eligible for the credit. Property on which construction has already begun can qualify but, if construction began prior to enactment, only the portion of the basis attributable to construction commenced after enactment would be eligible.

KPMG observation

The section 48D tax credit is similar to a proposal that was included in H.R. 5376, the "Build Back Better Act," that was approved by the House on November 19, 2021, but with some notable differences—including the availability of the 25% credit amount without having to satisfy wage and workforce requirements and the addition of the recapture rule.

There are some areas in which questions may arise and where additional clarity may be helpful. One such area for further clarity concerns the definition of an advanced manufacturing facility and, in particular, how far down the supply chain the credit may apply.

A notable feature of this credit is its refundability through a "direct pay" election. The direct pay concept is designed to address the fact that, in many cases, taxpayers will not have sufficient tax liability to use available credits and must rely on tax equity financing to assist in financing their projects. A refundable credit will allow taxpayers to benefit from the credit, regardless of tax liability. Tax professionals believe that the direct pay provision will likely require a substantial amount of IRS guidance to implement and administer, and such guidance may be developed in parallel with direct pay tax credits that are included in H.R. 5376 (the budget reconciliation bill that the Senate passed on August 7, 2022, and that the House is expected to consider on August 12, 2022).

Guidance also will be needed to address election and refund procedures, timing of refund, potential substantiation, and review of eligible basis, among other matters.

Taxpayers evaluating section 48D need to consider the timing and nature of their investments to determine eligibility. For instance, it will be necessary to understand when assets have or will be placed in service and whether such assets are acquired or self-constructed, as different considerations may apply. Taxpayers also need to consider how to most effectively use cost capitalization methodologies in determining their tax credit eligible basis.

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