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Insights: Alert

New U.S.-Japan Critical Minerals Trade Deal Opens the Door to Inflation Reduction Act EV Tax Credit for Japanese Companies

MARCH 31, 2023 Written by Stephen M. Anstey

On March 28, 2023, the United States and Japan signed a bilateral trade agreement to strengthen supply chains of critical minerals involved in electric vehicle battery production and to "ensure the free trade of such critical minerals." This trade agreement may allow Japanese companies greater access to the Inflation Reduction Act's (IRA's) lucrative Sec. 30D. Clean Vehicle Credit.

The Sec. 30D. Clean Vehicle Credit provides buyers up to $7,500 for qualifying new electric vehicles. Qualifying vehicles may receive the full amount of the credit if at least 50% of the "value of the components contained" in the battery are "manufactured or assembled in North America" and at least 40% of the "value of applicable critical minerals" used in production of the battery are "extracted or processed in the United States, or in any country with which the United States has a **free trade agreement in effect**." The "applicable critical minerals" include lithium, graphite, manganese, cobalt, and nickel.

While the United States has established comprehensive free trade agreements with over twenty countries, Japan is not one of them. This has left Japan (a critical U.S. ally and the second largest democratic economy in the world) and its companies ineligible to benefit from valuable IRA tax incentives. The new trade agreement on critical minerals may change that.

The IRA does not define several key terms concerning tax credits, including what constitutes a "free trade agreement." The Biden Administration hopes that this new self-styled free trade agreement on critical minerals will suffice. The free trade agreement is specifically tailored to create eligibility, explicitly circumventing "prohibitions or restrictions on imports of critical minerals," including lithium, graphite, manganese, cobalt, and nickel, from and between the two countries.

If this strategy is successful, the Biden Administration plans to use this trade deal as a "new framework" for its ongoing negotiations with the European Union—another U.S. ally and trade partner currently excluded on the same basis from benefitting from the Sec. 30D. Clean Vehicle Credit.

Whether the new trade deal will expand eligibility for some of the IRA's tax credits to Japanese companies will depend on Treasury's planned guidance. Having missed a deadline in December, Treasury is expected to issue a slate of regulations defining key IRA terms, including what constitutes a "free trade agreement," imminently.

We are monitoring these developments closely and will provide an updated analysis after Treasury's anticipated announcement.

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