

“Foreign Entity of Concern” and Its Impact under the Inflation Reduction Act

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This article is the first in a special series on overseas expansion of Chinese EV and EV battery companies.

1. Why has the definition of “Foreign Entity of Concern” drawn widespread attention?

“Foreign entity of concern” (“FEOC”) is a term that frequently appears in many recently enacted laws in the United States, including the CHIPS and Science Act, the Inflation Reduction Act (“IRA”), and the Infrastructure Investment and Jobs Act (the “Jobs Act”). In general, an entity designated as an FEOC and/or any products containing any components or materials produced or processed by an FEOC will be disqualified from being eligible for financial incentives and tax credits under these laws. Therefore, the definition of FEOC holds significant importance for Chinese companies doing business with the U.S., as well as Chinese-owned companies operating within the U.S., particularly in industries such as semiconductor chips, electric vehicles (“EVs”), EV batteries, and their interconnected supply chains.

On December 1, 2023, the U.S. Department of Energy (“DOE”) released proposed guidance defining FEOC under the Jobs Act (the “Proposed Guidance”), which holds particular relevance to Internal Revenue Code Section 30D – the Clean Vehicle Tax Credit – as well as the IRA. This comprehensive guidance aims to provide clarity on the definition of FEOC and the specific applications of the FEOC restrictions, carrying substantial implications for Chinese EV and EV battery manufacturers as well as their suppliers and customers.

2. What local content requirements does a clean vehicle need to meet to be qualified for the Section 30D tax credit under the IRA?

The IRA, enacted by the Biden-Harris administration in 2022, serves multiple purposes, including economic stimulus, job creation, and the promotion of American domestic manufacturing. A key focus of this law is to amplify the federal government’s financial support to the clean energy sector. To stimulate the sales of clean vehicles in the U.S., the U.S. federal government will provide a consumer tax credit of up to US\$7,500 for each purchase of a qualified EV, of which US\$3,750 is allocated to an EV meeting the “critical mineral” requirement, and the other US\$3,750 is assigned to an EV that meets the “battery component” requirement.

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3. How does the FEOC restriction disqualify certain EVs from the coverage of the Section 30D tax credit under the IRA?

In April 2023, the Treasury Department and the IRS released guidance on the clean vehicle provisions under the IRA, reaffirming the rule relating to the excluded entity provision of the Section 30D tax credit. Starting in 2024, vehicles containing battery components manufactured or assembled by an FEOC will be ineligible for the \$3,750 tax credit. Starting in 2025, vehicles whose batteries contain certain “critical minerals” extracted or processed by an FEOC will also be ineligible for the other \$3,750 tax credit.

According to this rule, if any supplier to an automotive OEM is identified as an FEOC, the resulting EV containing battery components and/or critical minerals produced or processed by such a supplier will be disqualified from the corresponding tax credit, and the automotive OEM will lose the subsidy advantages. In essence, when selecting suppliers for battery components and/or critical minerals, an automotive OEM or battery manufacturer will be incentivized to choose a non-FEOC supplier.

4. Which suppliers of battery, battery components or critical minerals would be considered FEOCs according to the Proposed Guidance?

Within the framework of the IRA, a particularly ambiguous facet of the FEOC definition pertains to foreign entities that are “owned by, controlled by, or subject to the jurisdiction or direction of a government of a foreign country that is a covered nation^[1].” The Proposed Guidance released on December 1 provided a further interpretation of such definition.

As per the Proposed Guidance, a foreign entity is an FEOC only if it falls under either scenario A or B below.

a. A foreign entity is subject to the jurisdiction of a covered nation’s government.

Under the Proposed Guidance, a foreign entity is “subject to the jurisdiction” of a covered nation’s government if:

(i) the foreign entity is incorporated or domiciled in, or has its principal place of business in, a covered nation; *or*

(ii) with respect to the critical minerals, components, or materials of a given battery, the foreign entity engages in the extraction, processing, or recycling of such critical minerals, the manufacturing or assembly of such components, or the processing of such materials, in a covered nation.

b. A foreign entity is owned by, controlled by, or subject to the direction of a covered nation’s government.

Under the Proposed Guidance, an entity is “owned by, controlled by, or subject to the direction” of another entity (including the government of a covered nation) if:

(i) 25% or more of the entity’s board seats, voting rights, or equity interest are cumulatively held by that other entity, whether directly or indirectly via one or more intermediate entities; *or*

(ii) with respect to the critical minerals, battery components, or battery materials of a given battery, the entity has entered into a licensing arrangement or other contract with another entity (a contractor) that entitles that other entity to exercise effective control over the extraction, processing, recycling, manufacturing, or

assembly (collectively, “production”) of the critical minerals, battery components, or battery materials that would be attributed to the entity.

Note that as per the definition of “foreign entity,” a U.S. subsidiary of a non-U.S. company is also deemed as a “foreign entity,” thus it could be considered an FEOC if it falls under either A or B above. However, a subsidiary of an FEOC is not automatically considered as an FEOC unless the subsidiary itself falls under either scenario A or B above.

5. “Government of a [covered nation]” is defined to include even individual government representatives. Which individuals would be counted as “government of a [covered nation]”?

The DOE proposed to interpret “government of a foreign country” to mean: (i) a national or subnational government of a foreign country; (ii) an agency or instrumentality of a national or subnational government of a foreign country; (iii) a dominant or ruling political party of a foreign country; or (iv) a current or former senior foreign political figure.

The DOE further explains that “Senior Foreign Political Figure” in (iv) of the definition means: (a) a senior official, either in the executive, legislative, administrative, military, or judicial branches of a foreign government (whether elected or not), or of a dominant or ruling foreign political party, and (b) an immediate family member (spouse, parent, sibling, child, or a spouse’s parent and sibling) of any individual described in (a).

The DOE also provided explanations of the above interpretation specifically regarding China. For more details, please refer to Section C of the proposed interpretive rules released by the DOE.

6. How can a Chinese supplier of battery, battery components or critical minerals determine whether their products may affect their clients’, i.e. automotive OEMs’, FEOC compliance?

Based on the Proposed Guidance and the examples of indirect control delineated by the DOE, in the table below, we analyzed different types of Chinese EV and EV battery suppliers under the definition of FEOC.

Please note that the terms of “state-owned enterprise”, “enterprise with non-controlling state ownership” and “non-state-owned company” in the table below carry the meanings commonly used in the Chinese context. In this context, “state-owned” denotes equity ownership equal to or exceeding 50% held by the state; “non-controlling state ownership” means equity ownership between 0% to 50% held by the state; and “non-state-owned company” refers to a company without any state ownership. However, it is crucial to be mindful that the definition of “government of a [covered nation]” under the Proposed Guidance is very broad. For example, as discussed in paragraph 5 above, certain individuals may be deemed as “government of a [covered nation]” according to the Proposed Guidance. A company controlled by such individuals may be deemed as

controlled by the “government of a [covered nation],” and thus becomes an FEOC.

Furthermore, for the purpose of determining a company’s FEOC status, it is imperative not only to review its direct and indirect equity ownership but also to delve into factors such as the board seats, voting rights, and contract arrangements. For example, certain type of companies in the table below may not be considered as an FEOC based on its equity ownership alone; however, it could still be considered as an FEOC if more than 25% of its board members are individuals falling within the extensive category of “Senior Foreign Political Figure”.

Types of Companies	FEOC Status
1. Chinese state-owned enterprise (incorporated in China), and its wholly-owned subsidiaries	FEOC, since it is directly or indirectly controlled by Chinese government through majority equity ownership.
2. Equity joint venture (incorporated, domiciled or with its principle place of business outside of China, the “JV”) with its controlling stake held by a Chinese state-owned enterprise (the “Parent”)	- If the Parent owns 25% or more equity or voting rights in JV, the JV is likely to be deemed as an FEOC. - If the Parent owns less than 25% equity or voting rights in the JV, and - if 25% or more of the board members of the JV are CCP members or current/former Senior Foreign Political Figures, the JV may be deemed as an FEOC; - if fewer than 25% of the board members of the JV are CCP members or current/former Senior Foreign Political Figures, but 25% or more of the board members of the Parent are CCP members or current/former Senior Foreign Political Figures, the Proposed Guidance does not offer a clear answer as to whether the JV is an FEOC. It is possible that indirect foreign government control via board members of the Parent may be extended to the JV, potentially resulting in the JV to be deemed as an FEOC. As the DOE is currently soliciting public comments to the Proposed Guidance, this issue may be further clarified in the final version of the rules established in the Proposed Guidance.
3. JV with its controlling stake held by an enterprise with non-controlling state ownership (the “Parent”)	If the state ownership or voting rights in the Parent amounts to 25% or more, the JV is likely to be deemed an FEOC.

	• If the state ownership or voting rights in the Parent amount to less than 25%, and – if 25% or more of board members of the JV are CCP members or current/former Senior Foreign Political Figures, the JV may be deemed as an FEOC; – if fewer than 25% of the board members of the JV are CCP members or current/former Senior Foreign Political Figures, but 25% or more of the board members of the Parent are CCP members or current/former Senior Foreign Political Figures, the Proposed Guidance does not offer a clear answer as to whether the JV is an FEOC. It is possible that indirect Chinese government control via board members of the Parent may be extended to the JV, potentially resulting in the JV to be deemed as an FEOC; – if each of the JV and the Parent has less than 25% board members as CCP members or current/former Senior Foreign Political Figures, the JV is not likely to be deemed as an FEOC.
4. JV with non-controlling equity interest held by an enterprise with non-controlling state ownership (the “Parent”)	• If, by multiplying the ownership percentages (by equity or by voting rights) at both the JV level and the Parent level, the resulting state ownership (by equity or by voting rights) in the JV is no less than 25%, the JV may be deemed as an FEOC. • If, by multiplying the ownership percentages (by equity or by voting rights) at both the JV level and the Parent level, the resulting state ownership (by equity or by voting rights) in the JV is less than 25%, and – if 25% or more of board members of the JV are CCP members or current/former Senior Foreign Political Figures, the JV may be deemed as an FEOC; – if fewer than 25% of the board members of the JV are CCP members or current/former Senior Foreign Political Figures, but 25% or more of the board members of

	the Parent are CCP members or current/former Senior Foreign Political Figures, the Proposed Guidance does not offer a clear answer as to whether the JV is an FEOC. It is possible that indirect foreign government control via board members of the Parent may be extended to the JV, potentially resulting in the JV to be deemed as an FEOC; – if each of the JV and the Parent has less than 25% board members as CCP members or current/former Senior Foreign Political Figures, then the JV is not likely to be deemed as an FEOC.
5. Non-state-owned company incorporated in China	• FEOC, since it is incorporated in China and subject to the jurisdiction of the Chinese government.
6. Wholly-owned subsidiary (incorporated, domiciled or with its principal place of business outside of China, the “Subsidiary”) of a non-state-owned company that is incorporated in China (the “Parent”)	• Although the Subsidiary is wholly owned by an FEOC, the Subsidiary is not automatically considered as an FEOC. Since there is no state ownership in such Subsidiary, the determination of whether the Subsidiary is an FEOC depends on the composition of the board of the Subsidiary and the board of the Parent. – If 25% or more of board members of the Subsidiary are CCP members or current/former Senior Foreign Political Figures, the Subsidiary may be deemed as an FEOC. – If fewer than 25% of the board members of the Subsidiary are CCP Members or current/former Senior Foreign Political Figures, but the Parent’ board comprises 25% or more CCP Members or current/former Senior Foreign Political Figures, the Proposed Guidance does not offer a clear answer as to whether the Subsidiary is an FEOC. It is possible that indirect foreign government control via board members of the Parent may be extended to the Subsidiary, potentially resulting in the Subsidiary to be deemed as an

	FEOC. Given that the Subsidiary represents the majority scenario of legal entities used by Chinese EV and EV battery companies in their investments in the United States, the final version of the Proposed Guidance to be published after public comments being solicited may include revised provisions or further clarifications on this issue. – If each of the Subsidiary and the Parent has less than 25% board members as CCP members or current/former Senior Foreign Political Figures, the Subsidiary is not likely to be deemed as an FEOC.
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The determination of FEOC status is extremely complex, requiring a careful facts-based review on a case-by-case basis. Should you have any inquiries regarding the determination of FEOC status of your company, please feel free to reach out to the authors of this article for further consultation.

[1] A covered nation refers to any of (A) the Democratic People's Republic of North Korea; (B) the People's Republic of China; (C) the Russian Federation; and (D) the Islamic Republic of Iran. For the purpose of this article, we only discuss the rules relevant to China.