# Inflation Reduction Act of 2022

August 2, 2022

## Highlights

- ✔ $739 Billion Bill Solely Supported by Democrats
- ✔ Return of Corporate AMT
- ✔ Closing of Carried Interest “Loophole”
- ✔ Extension of ACA Premium Reductions
- ✔ Massive Expansion and Extension of Green Energy Incentives

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SPECIAL REPORT

# Deal Reached on Scaled Back Reconciliation Bill

Late on July 27, 2022, a deal to revive a Democratic reconciliation package was announced by Senate Majority Leader Charles Schumer (D-N.Y.) and Senator Joe Manchin (D-W.Va.). The Inflation Reduction Act of 2022 provides investment in clean energy, promotes reductions in carbon emissions, and extends popular Affordable Care Act premium reductions. The bill is paid for through the implementation of a 15 percent corporate minimum tax, budget increases for the Internal Revenue Service to close the “tax gap,” the closing of a loophole for carried interest, and changes to Medicare rules. It is not yet clear if there are enough votes for the proposal to pass in the Senate, though Democratic leadership in the chamber hopes to have a vote before going on summer recess on August 5.

The Inflation Reduction Act of 2022 is the remnant of President Joe Biden’s Build Back Better Plan, a $6 trillion dollar proposal released in 2021 that comprised the majority of Biden’s domestic agenda. Part of that initial plan became law through the Infrastructure Investment and Jobs Act. During 2021, the remainder of the plan was negotiated down to $1.75 trillion and eventually passed in the House of Representatives on November 19, 2021. However, with an evenly divided Senate, the Build Back Better Act never even came up for a vote in the upper chamber as it did not have the support of all 50 Democrats.

For nearly a year, the proposal seemed dead. However, Schumer and Manchin surprised nearly everyone when they announced they had reached an agreement that Manchin, a key Senator in reaching the 50 votes required for passage, could support. This new version retains many of the key “green” provisions and carries a price tag under $1 trillion.

It is not yet clear that Democrats have the votes to secure passage. Further, to overcome a Senate filibuster, the Democrats are using the budget reconciliation process to pass the bill, meaning that the content of the bill must comply with Senate rules with regard to the process. Use of the reconciliation process also means that there is a deadline of September 30 for the bill to pass.

**COMMENT.** *While this is the closest Senate Democrats have come to passage of a bill that includes so much of Biden’s domestic agenda, this is not yet a done deal, and there could still be changes to many of the provisions. This Briefing will attempt to cover the highlights of the proposal as it currently stands.*

# REVENUE PROVISIONS

The proposed Inflation Reduction Act of 2022 is significantly smaller than any proposed version of the Build Back Better Act. As such, nearly all of the revenue-generating provisions of prior proposals have been eliminated. Only the corporate alternative minimum tax and increased IRS funding have survived from prior versions. A new provision closing the carried interest loophole, has been added to the latest proposal.

> *"The Inflation Reduction Act of 2022 is the remnant of President Joe Biden's Build Back Better Plan."*

## Corporate Alternative Minimum Tax

The proposed Inflation Reduction Act of 2022 resurrects the corporate alternative minimum tax (AMT) which was eliminated by the Tax Cuts and Jobs Act, although it returns in a slightly altered form. Proposed to be effective for tax years beginning after 2022, the new corporate AMT would equal 15 percent of the corporation's "adjusted financial statement income" for the tax year, reduced by a corporate AMT foreign tax credit. The tax would only apply to corporations with average annual adjusted financial statement income in excess of $1 billion for the three prior tax years. This threshold is reduced to $100 million in the case of certain foreign-parented corporations. Certain exceptions also apply to the determination of an applicable corporation where there is a change in ownership or a consistent reduction in income.

A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement, for purposes of determining when to include income for tax purposes. That amount is adjusted for various purposes, including certain adjustments in the case of consolidated returns or for certain foreign income.

## Carried Interest

The Inflation Reduction Act of 2022 is partially paid for by closing the so-called "carried interest loophole." Under the loophole, managers of hedge funds and other private equity funds share in the profits of the fund by receiving a share of the profits interest. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), those interests could then be sold as capital assets, meaning they were subject to reduced long-term capital gains treatment if held for longer than a year, despite being compensation for labor, which would normally be taxed at higher ordinary income rates. Under the TCJA, these managers must hold the interests for a minimum of three years to enjoy long-term capital gains treatment.

Under the proposal, the holding requirement is lengthened to five years, but only for those with incomes in excess of $400,000.

**COMMENT.** *The $400,000 limit is designed to keep Biden's campaign promise of no tax increases on taxpayers earning less than $400,000.*

## IRS Funding

A significant strategy in coming up with ways to pay for a large legislative package is by improving IRS service to close the "tax gap." The tax gap is the difference between what should be collected by the IRS and what is actually collected by the IRS. In many cases, the lack of resources by the IRS to enforce the nation's tax laws can be leveraged by taxpayers to lower their tax bills, and it is believed that a small investment in IRS resources can lead to an outsized increase in revenue.

The bill looks to close the tax gap by allocating an increased amount to the IRS to improve enforcement.

**COMMENT.** *There are no changes to the Internal Revenue Code to implement this improvement in IRS enforcement. The Build Back Better Act included some provisions relating to penalty assessment and backup withholding for third party settlements, but those have been eliminated. This provision only increases the IRS budget, so there is no direct impact on taxpayers (though there could be an increase in examinations due to the budget increases)*

# AFFORDABLE CARE ACT

The proposed bill extends Affordable Care Act provisions from the American Rescue Plan Act of 2021. Specifically, the expansion of affordability percentages used in calculating the premium tax credit to make credits available for individuals with incomes above 400 percent of the federal poverty line, as well as credit amounts for those already qualified, would apply through 2025. Without the extension, these provisions would expire at the end of 2022.

# RESEARCH CREDIT FOR SMALL BUSINESSES

In tax years beginning after 2015, certain qualified small business are allowed to claim a limited amount of the research credit against payroll taxes. Under the proposed Inflation Reduction Act of 2022, in tax years beginning after 2022, the amount of this limitation is increased from $250,000 to $500,000.

# GREEN ENERGY

The majority of the outlays in the Inflation Reduction Act of 2022 are devoted to incentives for green energy. A large share of those outlays are in the form of tax credits for green energy. In some cases, the credits are extensions and expansions of current credits, such as those for electric vehicles or residential energy property. However, the bill also proposes new credits, such as those for the production of clean electricity.

> **COMMENT.** *This is the largest portion of the Build Back Better Act to survive to the new bill. Most of the energy tax credits that were in the original proposal are here, though in some cases modified or with a shorter termination date.*

## Electricity Produced from Renewable Resources

The proposal extends the credit for electricity produced from certain renewable resources through 2024. An increased credit may be claimed if the entity meets certain workforce and wage requirements in construction or operation of the facility.

## Energy Investment Credit

The energy investment credit is also extended through 2024, with workforce/wage credit enhancements like the renewable electricity credit. An enhancement of the credit is also available for solar facilities placed in service in connection with low-income communities.

## Elective Direct Payment

In lieu of a tax credit, entities can elect to claim a direct payment for certain energy projects. The credits for which a direct payment can be claimed include the alternative fuel refueling property credit, the renewable electricity production credit, the carbon oxide sequestration credit, the energy investment tax credit, and the qualifying advanced energy project credit. A penalty will apply if the taxpayer receives a larger direct payment than the credit to which it is entitled.

## Residential Energy Incentives

The credit for nonbusiness energy property, which expired at the end of 2021, is modified and extended through 2032 by the proposal. This credit applies to energy efficient windows and doors, as well as certain HVAC systems and heat pumps, and the lifetime maximum for the credit is replaced with an annual limit of $1,200. The residential energy efficient property credit, renamed the clean energy credit, is extended through 2034.

## Clean Vehicles

The credit for the purchase of clean vehicles (which includes both plug-in electric vehicles and fuel cell vehicles) is extended through 2032, and modified, under the proposal. The proposal eliminates the current credit's limitation on the number of vehicles produced by a specific manufacturer. However, the credit imposes sourcing requirements on the critical components of the vehicle and battery systems. The maximum amount of the credit remains at $7,500, but includes income limitations, as well as limitations on the manufacturer's suggested retail price.

A new credit of up to $4,000 is also available for the purchase of a previously-owned clean vehicle, subject to income limitations, through 2032. The bill also proposes a new credit for up to 30 percent of the basis of a qualified commercial clean vehicle acquired after 2022 and before 2033.

## Other New Green Energy Credits

Additional new credits to encourage the growth of the green energy industry proposed in the Inflation Reduction Act of 2022 include the following:

- A credit of .3 cents per kilowatt-hour for energy produced from a zero-emission nuclear power facility, after 2023 and before 2033;
- A credit for sustainable aviation fuel sold or used after 2022;
- A credit for the production of clean hydrogen after 2022;

## Other Extended and Modified Green Energy Credits

The Inflation Reduction Act of 2022 also proposes modifications to other existing energy credits while also extending them. The bill's proposed changes include:

- The carbon oxide sequestration credit is modified and extended through 2032;
- Incentives for biodiesel, renewable diesel, alternative fuel, and alternative fuel mixtures are modified and extended through 2024;
- The credit for second generation biofuels is extended through 2025;

- The energy efficient commercial buildings deduction is modified for tax years beginning after 2022;
- The new energy efficient home credit is modified and extended through 2032;
- The alternative fuel refueling property credit is increased and extended through 2032;

## PROPOSALS NOT INCLUDED

Several provisions were removed from the version of the bill that passed the House as the Build Back Better Act. Many of the proposals that were billed as promoting "human infrastructure" were eliminated. These include provisions that extended COVID-era expansions of the child tax credit and earned income tax credit.

**COMMENT.** *Some economists believe that the expansion of credits in 2021 played a part in leading to high inflation. As this proposed legislation is billed as something to reduce inflation, it is not surprising to see these provisions dropped.*

The Build Back Better Act also included the restoration of the individual deduction for state and local taxes (the "SALT deduction"). The Inflation Reduction Act of 2022 does not include a restoration of the SALT deduction.

**COMMENT.** *The lack of a SALT deduction could make it difficult to pass the bill, especially in the House where many lawmakers from higher-tax states have demanded the return of the deduction. However, the SALT deduction, even with income limitations, is very expensive, and is widely seen as disproportionally advantageous to higher income taxpayers, so inclusion of the provision could scare off other lawmakers concerned with the cost, or the optics, of the bill.*

Finally, the Inflation Reduction Act of 2022 does not include changes to the business interest expense deduction or any of the proposed changes for international taxpayers that were included in the Build Back Better Act the House passed in 2021.

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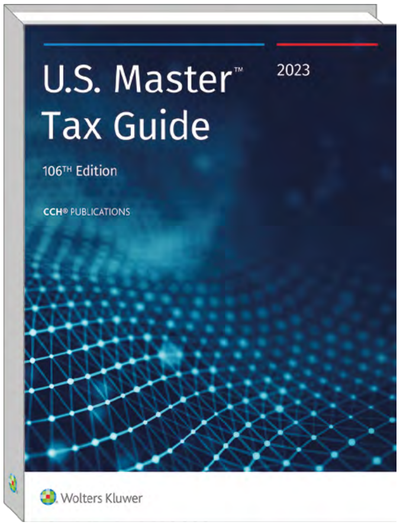


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