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Summary of Important Tax Provisions Included in the Recently Announced Inflation Reduction Act of 2022

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On July 27, 2022, Senator Joe Manchin and Senate Majority Leader Chuck Schumer announced that they have reached an agreement on a budget reconciliation bill (the Inflation Reduction Act of 2022, the “Act”). Although the Act is not as ambitious as the earlier $3.5 trillion “Build Back Better” plan that failed to get enough support to pass in the Senate, the Act would further President Biden’s clean energy initiatives by raising tax revenue to pay for a generous package of clean energy tax incentives. Specifically, the Act, would, among other things: (i) establish a 15 percent corporate minimum tax, (ii) modify the carried interest rules to apply short-term capital gains rates unless an increased holding period requirement is satisfied, and (iii) provide expansive tax benefits for the clean energy sector, including extending the section 48 investment tax credit (“ITC”) and section 45 production tax credit (“PTC”), providing for stand-alone storage to qualify as ITC eligible property and adding a new tax credit for clean hydrogen.

Importantly, the Act does not include any relief from the $10,000 cap on the federal individual itemized deductions for state and local taxes, which may create some obstacles for the legislation in the House, where some Democratic representatives have promised to block any proposals that do not address the state and local tax deduction limitation.

The Act estimates $739 billion of revenues would be raised from (i) the addition of a corporate minimum tax and changes to the carried interest rules, (ii) savings from changes in federal prescription drug policies, and (iii) increased IRS enforcement.

The following are some highlights of important tax provisions included in the Act:

Establishing a 15% Corporate Minimum Tax

- The Act creates a Corporate Alternative Minimum Tax (“AMT”) equal to a 15 percent minimum tax on adjusted financial statement income for corporations with profits in excess of $1 billion.

- Corporations would generally be eligible to claim net operating losses and tax credits against the AMT, and would be eligible to claim a tax credit against the regular corporation tax for AMT paid in prior years, to the extent the regular tax liability in any year exceeds 15 percent of the corporation's adjusted financial statement income.

- This provision would be effective for taxable years beginning after December 31, 2022.

Modifying the Carried Interest Rules

- Under current law, a three-year holding period is required to achieve long-term capital gain for carried interest payable to managers of certain investment partnerships.

- Subject to certain limited exceptions, the Act would replace the three-year holding period with a five-year holding period requirement that would need to be satisfied in order for taxpayers with adjusted gross income of $400,000 or more to be eligible for the preferential long-term capital gain treatment with respect to carried interests in certain partnerships.

- The Act modifies the statutory language of Section 1061 to make it clear that these rules will apply to a carried interest held by an "S corporation."

- Under current law, certain types of income subject to tax at long-term capital gains rates are excluded from the scope of Section 1061, including amounts treated as long-term capital gain with respect to regulated futures contracts marked to market under Section 1256, long-term capital gain under Section 1231, and qualified dividend income from domestic and certain foreign corporations. The Act would expand the scope of Section 1061 to apply to all items of income that are subject to tax at rates applicable to capital gains.

- Pursuant to the Act, the Treasury is authorized to issue Treasury Regulations or other guidance "to prevent the avoidance of the purpose of Section 1061, including through the distribution of property by a partnership and through carry waivers."

- This provision would be effective for taxable years beginning after December 31, 2022.

Expanding, Extending, and Adding New Energy Tax Credits

- Extends the ITC and PTC for eligible projects (e.g., wind, solar, biomass, and hydropower) that start construction before January 1, 2025 and for geothermal projects that start construction before January 1, 2035. Other ITC and PTC changes include: (i) a PTC for solar; (ii) expansion of ITC eligible property to include stand-alone energy storage, qualified biogas and microgrid controllers; (iii) implementation of a two-tier rate structure that requires satisfaction of prevailing wage and apprenticeship requirements to get the full rate; and (iv) addition of a limited 10 percent bonus credit.

- A new tax credit for the production of clean hydrogen after December 31, 2022 at a qualified facility that starts construction before January 1, 2033.

- New technology neutral tax credits beginning January 1, 2025 for zero emissions facilities. There are also zero emissions tax credits for (i) the production of clean energy or nuclear power and (ii) electric generating or energy storage facilities.

- The Section 45Q carbon capture and sequestration credit is extended for projects that begin construction prior to January 1, 2033. In addition, the minimum carbon capture requirement is lower and there is an enhanced credit for certain direct air capture facilities.
- There is a new Alternative Manufacturing Production Credit available to taxpayers that produce and sell certain components (generally comprising part of clean energy facilities) that are produced in the United States and sold to unrelated persons.
- Other positive changes are (i) transferability of most energy tax credits; (ii) a limited direct pay option; and (iii) a 3-year carryback period for energy credits.

Senator Schumer announced in a July 27 statement that the text of the Act would be submitted to the Senate for a review, and that he expects that the Senate "will vote on this transformative legislation next week." The Senate currently is scheduled to begin its August recess at the end of this week, and the House's scheduled recess began this week; however, if the legislation passes in the Senate, it would not be surprising to see the House take up the legislation shortly thereafter.

In a statement made by President Biden on July 27, the President expressed support for the Act, stating, "I urge the Senate to move on this bill as soon as possible, and for the House to follow as well." Although much needs to be done before the Act can be placed on President Biden's desk for signature, in order to satisfy the complex requirements of the reconciliation process, which will allow the Act to pass with a simple majority in the Senate, Democrats are expected to push aggressively to get this legislation passed and ready for the President's signature by September 30.

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