

Inflation Reduction Act clears Senate

The Senate voted 51-50 on August 7 to approve the Inflation Reduction Act of 2022, the roughly \$740 billion budget reconciliation package that includes some targeted corporate tax increases, a large increase in funding for the Internal Revenue Service, incentives to promote climate change mitigation and clean energy, and provisions to promote health care affordability.

Passage came along strict party lines with all 50 of the chamber's Democrats aligned in support of the bill, all 50 Republicans in opposition, and Vice President Kamala Harris breaking the tie.

This special edition of *Tax News & Views* looks at the major tax provisions in the legislation and what lies ahead as it moves to consideration in the House.

What's changed—and what hasn't

The measure as approved follows the contours of the proposal that was unveiled by Majority Leader Charles Schumer, D-N.Y., and Sen. Joe Manchin, D-W.Va., on July 27. But it also incorporates some significant modifications at the behest of Arizona Democratic Sen. Kyrsten Sinema, who had expressed reservations about specific revenue provisions in the original version and whose support was essential to getting the package through an evenly divided Senate. Those changes include:

URL: https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_of_2022.pdf

- Narrowing a proposed book minimum tax on certain large corporations;
- Scrapping a provision that would have tightened current-law rules governing the tax treatment of carried interest income;
- Adding a 1 percent excise tax on corporate stock buybacks; and
- Adding an extension of the excess business loss rules.

Sinema had been critical of the carried interest changes in the original Schumer-Manchin proposal and had told the majority leader that she would not support the bill unless the provision was removed.

"[She] said she would not vote for the bill, not even move to proceed, unless we took it out," Schumer told reporters August 5. "We had no choice."

Sinema also had expressed concerns recently that the proposed minimum tax on book income of certain large companies—an idea Democrats latched onto last year in the face of her opposition to increasing statutory corporate tax rates—would have an outsized impact on heavy users of accelerated depreciation, notably manufacturers.

'Byrd Bath' leaves tax title intact: Significantly, all of the tax provisions survived what's informally known as the "Byrd Bath," the review process undertaken by the Senate parliamentarian to determine whether or not each provision in the bill complies with the strict requirements of the "Byrd Rules" governing budget

reconciliation legislation. (Provisions that do not meet Byrd Rule requirements must be scrapped or modified to become compliant unless supporters can get 60 votes in favor of a motion to waive the underlying point of order.)

Revenue impact: As expected, the modifications made to the bill changed its estimated revenue impact. A “very preliminary” estimate released by the Joint Committee on Taxation staff on August 6 indicates that the revised bill that Schumer and Manchin released on August 4 would increase federal revenues by \$73.5 billion between 2022 and 2031; however, a further revision to the revenue score likely will be necessary to account for the last-minute change to the corporate minimum tax and the extension of the excess business loss rules that were adopted shortly before the vote on final passage (more on that below).

URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220807_1_suppB.pdf

Corporate minimum tax

The Inflation Reduction Act includes a book minimum tax (AMT) similar to one originally proposed in the Build Back Better legislation approved in the House last year that would impose a 15 percent minimum tax on “adjusted financial statement income” (AFSI) of applicable corporations over the “corporate AMT foreign tax credit for the taxable year.”

Under the bill, an applicable corporation’s minimum tax would be equal to the amount by which the tentative minimum tax exceeds the corporation’s regular tax for the year increased by the corporation’s BEAT liability under section 59A. For this purpose, an applicable corporation generally is any corporation (other than an S corporation, regulated investment company, or a real estate investment trust) with three-year average annual AFSI that exceeds \$1 billion.

Although similar to other corporate AMT proposals, the Senate-approved bill contains a few notable modifications, including:

- A change to the language addressing the amount of income that is taken into account and attributable to the holding of stock in a corporation that not a member of the US consolidated group. In such cases, “adjusted financial statement income of the taxpayer with respect to such other corporation shall be determined by only taking into account the dividends received from such other corporation or inclusions required under subpart F or GILTI.” Although not expressly provided for in legislative text or legislative history, it is our understanding that the intent of this provision is to exclude amounts otherwise taken into account with respect to unrealized gains and losses on stock (for example, under the mark-to-market method of accounting).
- A special rule addressing the treatment of amounts attributable to covered benefit plans.
- A provision modifying the treatment of amounts deductible under section 168 or under section 197 with respect to “qualified wireless spectrum.” When applicable, these provisions substitute the amount taken into account as a deduction in computing taxable income for the taxable year for the amount of expense that is taken into account in the taxpayer’s applicable financial statement.

- In a surprising last-minute addition during the vote-a-rama process—which allows senators to offer an unlimited number of amendments as long as they are germane to the underlying reconciliation bill and under a timeline limited only by members’ collective stamina—the Senate passed an amendment to remove an expanded aggregation rule under section 52, which would have applied solely with respect to the book minimum tax, and extend the excess business loss rules under section 461(l) for two years through taxable years beginning before January 1, 2029, to replace the lost revenue. (The now-deleted expanded aggregation rule was substantially similar to the one included in the House-approved version of the Build Back Better Act, although the proposed Senate rule would have limited the expansion of the aggregation rule to only the book minimum tax.)

The new minimum tax would be effective for taxable years beginning after December 31, 2022.

Excise tax on stock buybacks

The measure would add new Internal Revenue Code section 4501 to provide that a covered corporation is subject to a tax equal to 1 percent of the fair market value of any stock of the corporation that is repurchased by such corporation during any taxable year (subject to certain exceptions).

A covered corporation means a domestic corporation, the stock of which is traded on an established securities market. For purposes of calculating the tax, the fair market value of the repurchased stock is reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including stock issued or provided to employees of the covered corporation and employees of specified affiliates. Purchases of covered corporation stock by specified affiliates would be treated as repurchased by the covered corporation. The tax also would apply to repurchases of stock of certain foreign corporations. New section 4501 would apply to repurchases of stock made after December 31, 2022.

IRS funding boost to improve taxpayer compliance

The bill would provide the Internal Revenue Service approximately \$80 billion in additional appropriations (available over 10 years), primarily to enhance its tax enforcement and compliance efforts. According to Schumer and Manchin (who cited estimates from the nonpartisan Congressional Budget Office), the more robust compliance and enforcement regime that would be made possible by the funding boost would generate an additional \$203 billion of tax revenue that was owed to the government but not paid. That projection was confirmed by the CBO in an estimate it released on August 3.

Here’s how the additional funding in the legislation would be allocated across the Service’s four program areas:

- \$3.2 billion for **taxpayer services** (for example, pre-filing assistance and education, filing and account services, taxpayer advocacy services, and other authorized services);
- \$45.6 billion for tax **enforcement activities** (such as determining and collecting owed taxes, providing legal and litigation support, conducting criminal investigations and using investigative technology in the

investigations, providing digital asset monitoring and compliance activities, enforcing criminal statutes related to violations of internal revenue laws and other financial crimes, purchasing and hiring passenger motor vehicles, and providing other authorized other services);

- \$25.3 billion for **operations support** (for example, rent payments; facilities services; printing; postage; physical security; headquarters and other IRS-wide administration activities; research and statistics of income; telecommunications; information technology development, enhancement, operations, maintenance, and security; the hire of passenger motor vehicles; the operations of the Internal Revenue Service Oversight Board; and other authorized services); and
- \$4.8 billion for **business systems modernization** (such as development of callback technology and other technology to enhance customer service but not including the operation and maintenance of legacy systems).

The legislation expressly states that the additional funds are not intended to increase taxes on any taxpayer with a taxable income below \$400,000, although this is just a statement of intent and is not binding on the Service's use of the money.

These appropriated funds would remain available until September 30, 2031. If the proposal is enacted, the IRS would be required to provide a report to Congress detailing how the funds will be spent. After the initial report, the IRS must provide Congress quarterly reports regarding the implementation of its plan.

The bill also would provide \$15 million of funds for the IRS to prepare and deliver a report to Congress within nine months of enactment on the cost of developing and running a free direct e-file tax return system.

These provisions would take effect upon enactment.

The measure that was brought to the floor does *not* include a provision from the original Schumer-Manchin proposal released July 27 that would have given the IRS greater flexibility with respect to personnel, including certain "direct-hire" authority. IRS officials have told House and Senate taxwriters at several hearings this year that direct-hire authority would give the Service greater flexibility in attracting experienced tax professionals as well as support personnel since it would allow the agency to onboard new hires in as few as 30 to 45 days (compared to six to eight months under normal government hiring procedures).

Superfund excise tax

The measure would reinstate and increase the hazardous substance Superfund financing rate on crude oil and imported petroleum products, indexed to inflation, effective after January 1, 2023, and before December 31, 2032. (The Infrastructure Innovation and Jobs Act that was signed into law last year reinstated and modified other Superfund excise taxes on the production of certain chemicals through December 31, 2031.)

Extension of Black Lung Disability Trust Fund tax

The bill would permanently extend the tax imposed on the sale of coal, which finances the Black Lung Disability Trust Fund, effective for sales in calendar years beginning after the date of enactment.

Excise tax on certain pharmaceutical manufacturers

The bill includes a provision that, broadly speaking, would require pharmaceutical manufacturers to negotiate with the federal government to determine maximum prices for certain selected prescription drugs and insulin products offered under Medicare. Pharmaceutical manufacturers that do not participate in the mandatory price-setting program would be subject to a new “manufacturers excise tax” that would apply to all sales by a manufacturer, producer, or importer of those products that are subject to a negotiated price cap. The tax rate initially would be set at 65 percent and would increase incrementally, up to a maximum of 95 percent, for taxpayers that fail to meet certain compliance benchmarks that are laid out in the bill.

The provision would be effective for sales after the date of enactment.

Clean-energy tax incentives

On the incentive side, the Inflation Reduction Act includes a number of tax and nontax provisions that Schumer and Manchin have contended will bring down consumer energy costs, increase American energy security, and reduce greenhouse gas emissions, with the goal of putting the US on a path to roughly 40 percent emissions reduction by 2030.

Certain tax credits proposed in the legislation include a direct-pay option as well as transferability provisions.

Some of the more notable tax-focused provisions are briefly highlighted here. A more detailed discussion will be published by Deloitte Tax LLP’s Periods, Methods and Credits Group in the coming days.

Reducing consumer energy costs: The bill would extend a number of tax credits aimed at bringing down the cost of residential energy-efficiency improvements such as heat pumps, rooftop solar systems, and electric HVAC systems and water heaters.

The measure also calls for a \$4,000 credit to make it more affordable for certain lower- and middle-income individuals to purchase used clean-energy vehicles. A credit of up to \$7,500 would be available for the purchase of new clean-energy vehicles. (Sen. Manchin had contended that similar incentives in earlier iterations of the Build Back Better legislation were focused on more expensive vehicles that were intended to appeal primarily to affluent taxpayers.)

Promoting American energy security and domestic manufacturing: The measure includes tax and nontax provisions intended to improve reliability of the US energy grid and promote domestic clean-energy manufacturing.

Among the tax-focused provisions are production tax credits to accelerate US manufacturing of solar panels, wind turbines, and critical minerals processing. Also included is an investment tax credit to build clean technology manufacturing facilities that produce electric vehicles, wind turbines, solar panels, and similar clean-energy property.

Decarbonizing the economy: The bill calls for an array of tax and nontax provisions aimed at reducing emissions from energy production, transportation, industrial manufacturing, buildings, and agriculture.

Specifically, it includes tax credits for clean sources of energy and energy storage, tax credits for clean fuels and clean commercial vehicles to reduce emissions within the transportation sector, and tax credits to reduce emissions from industrial manufacturing processes.

Supporting farmers, forestland owners, and rural communities: The bill proposes investments in clean-energy development in rural communities, including through tax credits to support the domestic production of biofuels and to build the infrastructure needed for sustainable aviation fuel and other biofuels.

Promoting environmental justice: To support the goal of expanding environmental justice efforts, many of the clean-energy tax credits in the bill include either a bonus rate or set-aside for investments in economically distressed communities.

Other tax relief provisions

The Inflation Reduction Act includes a handful of incentives targeted to certain small businesses, low- and moderate-income individuals who purchase health care insurance on one of the Affordable Care Act exchanges, and farmers.

Research credit against payroll tax for small businesses: A qualified small business may elect under current-law section 41(h) to apply up to \$250,000 of its research credit computed under section 41 against the employer portion of its FICA payroll tax liability imposed under section 3111(a) for up to five tax years. A qualified small business is a partnership, corporation, or person with gross receipts of less than \$5 million for the current tax year and no gross receipts for any taxable year preceding the five taxable year period ending with the current taxable year.

The legislation would increase the amount of research credit that can be applied against payroll tax liability from \$250,000 to \$500,000 for years beginning after December 31, 2022. Additionally, the legislation provides that the first \$250,000 of the credit limitation will be applied against the FICA payroll tax liability and the second \$250,000 of the limitation will be applied against the employer portion of Medicare payroll tax liability imposed under section 3111(b).

Affordable Care Act premium enhancements: The bill would extend through 2025 temporary provisions that reduce an individual's or family's share of premiums used in determining the amount of the premium-

assistance credit under the Patient Protection and Affordable Care Act and make the credit available to taxpayers with incomes above 400 percent of the federal poverty line for the applicable family size.

These premium-assistance enhancements were enacted in 2021 as part of the American Rescue Plan and are scheduled to expire at the end of this year.

Income exclusion for certain assistance to farmers: The legislation generally provides that certain payments to farmers and ranchers authorized in the American Rescue Plan Act of 2021 would not be included in the gross income of the payee, and any otherwise-allowable deductions would continue to be deductible notwithstanding the tax-free treatment of the payment.

House vote set for August 12

The Inflation Reduction Act now heads across the Rotunda to the House, where it is also expected to be approved along party lines. But that process could be a nail-biter, since Speaker Nancy Pelosi, D-Calif., is operating with a slim Democratic majority and can afford for no more than four of her members to oppose the legislation if it is to win passage. (House Republicans, like their Senate counterparts, remain united in opposition to the bill.)

The House is currently away for its August recess, but Majority Leader Steny Hoyer, D-Md., recently announced that lawmakers will return to Washington on August 12 to debate and vote on the measure.

- Prepared by the tax professionals in the Washington National Tax practice
Deloitte Tax LLP

This document contains general information only and Deloitte is not, by means of this document, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this document.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms, and their related entities (collectively, the “Deloitte organization”). DTTL (also referred to as “Deloitte Global”) and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.