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President Biden Signs Inflation Reduction Act into Law

Tax Talk Blog on **August 16, 2022**

On August 16, 2022 President Biden signed the Inflation Reduction Act of 2022 (the "IRA") into law.

The IRA includes a 15% corporate alternative minimum tax, a 1% excise tax on stock buybacks and a two-year extension of the excess business loss limitation rules. The IRA also contains a number of energy tax provisions.

I. Main Tax Provisions

1. *15% corporate alternative minimum tax*

The IRA imposes a 15% corporate alternative minimum tax based on the financial statement income of corporations or their predecessors with a three-year taxable year average annual adjusted financial statement income in excess of $1 billion. The corporate alternative minimum tax is effective for tax years beginning after December 31, 2022.

The 15% corporate alternative minimum tax is equal to the difference between a corporation's "adjusted financial statement income" for the taxable year and the corporation's "alternative minimum tax foreign tax credit" for the taxable year. A corporation's tax liability is the greater of its regular tax liability and the 15% alternative minimum tax.

A corporation's annual adjusted financial statement income is based on its book income, with certain adjustments, such as to account for a corporation's activities undertaken indirectly through a consolidated group, a partnership, or a disregarded entity. The adjusted financial statement income is also adjusted for certain taxes, such as federal income and excess profits taxes, and accelerated depreciation.

The average annual adjusted financial statement income of a corporation includes any other entities that are treated as a single employer with the corporation under section 52 to determine whether the corporation satisfies the $1 billion threshold.[1] This may cause corporations with less than $1 billion of adjusted financial statement income to be subject to the tax; however, portfolio companies of an investment fund generally will not be aggregated with other portfolio companies for purposes of the $1 billion threshold.

For corporations in existence for less than three years, the three-year income test is applied over the period during which the corporation was in existence. The adjusted financial statement income of a corporation with a taxable year shorter than 12 months is applied on an annualized basis.

Corporations generally are eligible to claim net operating losses and tax credits against the alternative minimum tax. Adjusted financial statement income is reduced by the lesser of (i) the aggregate amount of financial statement net operating loss carryovers to the taxable year and (ii) 80% of adjusted financial statement income (reflecting the tax rule that net operating losses are permitted to offset only 80% of taxable income). The IRA's clean energy credits and other business credits would be limited to 75% of a corporation's alternative minimum tax. In addition, a corporation is eligible to claim a credit for corporate alternative minimum tax paid in prior years against the regular corporate tax if the regular tax liability exceeds 15% of the corporation's adjusted financial statement income.

The corporate alternative minimum tax applies to a foreign-parented corporation (i.e., a U.S. subsidiary of a foreign parent) if its three-year taxable year average annual adjusted financial statement income exceeds $100 million and that of the foreign-parented multinational group exceeds $1 billion.[2] It is not clear whether the $100 million threshold is tested on a separate basis or on aggregate basis so that, for example, the adjusted financial statement income of two domestic subsidiaries of a common foreign parent (neither of which would separately meet the $100 million threshold) would be aggregated. The Secretary has the authority to issue regulations on the threshold tests.

The corporate alternative minimum tax does not apply to S corporations, regulated investment companies, or real estate investment trusts. In addition, the tax does not apply to corporations that have had a change in ownership or has a specified number of consecutive taxable years that will be determined by the Secretary.

The corporate alternative minimum tax does not conform to the "qualified domestic minimum top-up tax" proposed by the OECD/G20. As a result, if the OECD/G20 rules are adopted in their current form, the foreign subsidiaries of U.S. multinationals located or doing business in OECD countries could be subject to additional taxes by those jurisdictions.

2. *Excise tax on corporate stock buybacks*

The IRA imposes a nondeductible 1% excise tax on stock repurchases by publicly traded corporations and certain "surrogate foreign corporations".[3] The tax applies to repurchases of stock after December 31, 2022.

The tax is imposed on the fair market value of the stock "repurchased" by the corporation during the tax year, reduced by value of stock issued by the corporation during the tax year (including those issued to the employees). The term "repurchase" is defined as a redemption within the meaning of section 317(b), which is a transaction in which a corporation acquires its stock from a shareholder (and is not a dividend for federal income tax purposes).

The tax is also imposed on a corporation if its "specified affiliate" repurchases the corporation's stock from another person (including another "specified affiliate"). The term "specified affiliate" is defined as (i) any corporation in which the taxpayer-corporation directly or indirectly owns more than 50% of the stock by vote or value; and (ii) any partnership in which the taxpayer-corporation directly or indirectly holds more than 50% of the capital or profits interests.

In addition, the tax is imposed on a specified affiliate (i.e., a domestic subsidiary) of a non-U.S. publicly traded corporation that purchases the non-U.S. corporation's stock from another person (excluding another specified affiliate of the non-U.S. corporation).

If a surrogate foreign corporation (or its specified affiliate) repurchases its stock, the tax is imposed on the surrogate foreign corporation's expatriated entity (i.e., its U.S. subsidiary).

Repurchases that are (i) dividends for federal income tax purposes, (ii) part of tax-free reorganizations, (iii) made to contribute stock to an employee pension plan or ESOP, (iv) made by a dealer in securities in the ordinary course of business, or (v) made by a RIC or a REIT is not be subject to the excise tax. Repurchases that are less than $1 million in a year is also excluded.

The IRS has the authority to issue regulations to prevent abuse through the above exclusions and apply the rules to other classes of stock and surrogate foreign corporations. It is not clear how broad that authority is intended to be and whether the Secretary will issue guidance on certain common transactions, such as redemptions of preferred stock or of a non-publicly traded subsidiary's debt that is exchangeable for its publicly-traded parent's stock.

3. *Extension of excess business loss limitation rules*

Under pre-IRA law, for taxable years that begin before January 1, 2027, non-corporate taxpayers may not deduct excess business loss (generally, net business deductions over business income) if the loss is in excess of $250,000 ($500,000 in the case of a joint return), indexed for inflation. The excess loss becomes a net operating loss in subsequent years and is available to offset 80% of taxable income each year.

The IRA extends the excess business loss limitation rules to taxable years that begin before January 1, 2029.

The IRA's amendments apply to taxable years beginning after December 31, 2026.

II.Energy Tax Provisions

1. *Extension and expansion of production tax credit*

Section 45 of the Internal Revenue Code provides a tax credit for renewable electricity production. To be eligible for the credit, a taxpayer must (i) produce electricity from renewable energy resources at certain facilities during a ten-year period beginning on the date the facility was placed in service and (ii) sell that renewable electricity to an unrelated person. Under pre-IRA law law, the credit was not available for renewable electricity produced at facilities whose construction began after December 31, 2021.

The IRA extends the credit for renewable electricity produced at facilities whose construction begins before January 1, 2025. The credit for electricity produced by solar power –which expired in 2016—is reinstated, as extended by the IRA.

The IRA also increases the credit from 1.5 to 3 cents per kilowatt hour of electricity produced.

A taxpayer will be entitled to increase its production tax credit by 500% if (i) its facility's maximum net output is less than 1 megawatt, (ii) it meets the IRA's prevailing wage and apprenticeship requirements,[4] and (iii) the construction of its facility begins within fifty-nine days after the Secretary publishes guidance on these requirements.

In addition, the IRA adds a 10% bonus credit for a taxpayer (i) that certifies that any steel, iron, or manufactured product that is a component of its facility was produced in the United States (the "domestic content bonus credit") or (ii) whose facility is in an energy community (the "energy community bonus credit").[5]

2. *Extension, expansion, and reduction of investment tax credit*

Section 48(a) provides an investment tax credit for the installation of renewable energy property. The amount of the credit is equal to a certain percentage (described below) of the property's tax basis. Under pre-IRA law, the credit was limited to property whose construction began before January 1, 2024.

The IRA extends the credit to property whose construction begins before January 1, 2025. This period is extended to January 1, 2035 for geothermal property projects. The IRA also allows the investment tax credit for energy storage technology, qualified biogas property, and microgrid controllers.

The IRA reduces the base credit from 30% to 6% for qualified fuel cell property; energy property whose construction begins before January 1, 2025; qualified small wind energy property; waste energy recovery property; energy storage technology; qualified biogas property; microgrid controllers; and qualified facilities that a taxpayer elects to treat as energy property. For all other types of energy property, the base credit is reduced from 10% to 2%.

A taxpayer is entitled to increase this base credit by 500% (for a total investment tax credit of 30%) if (i) its facility's maximum net output is less than 1 megawatt of electrical or thermal energy, (ii) it meets the prevailing wage and apprenticeship requirements, and (iii) its facility begins construction within fifty-nine days after the Secretary publishes guidance on these requirements.

In addition, a taxpayer is entitled to a 10% domestic content bonus credit and 10% energy community bonus credit (subject to the same requirements as for bonus credits under section 45). The IRA also adds a (i) 10% bonus credit for projects undertaken in a facility with a maximum net output of 5 megawatts and is located in low-income communities or on Indian land, and (ii) 20% bonus credit if the facility is part of a qualified low-income building project or qualified low-income benefit project.

3. *Section 45Q (Carbon Oxide Sequestration Credit)*

Section 45Q provides a tax credit for each metric ton of qualified carbon oxide ("QCO") captured using carbon capture equipment and either disposed of in secure geological storage or used as a tertiary injection in certain oil or natural gas recovery projects. While eligibility for the section 45Q credit under pre-IRA law required that projects begin construction before January 1, 2026, the IRA extends credit eligibility to those carbon sequestration projects that commence construction before January 1, 2033.

The IRA increases the amount of tax credits for projects that meet certain wage and apprenticeship requirements. Specifically, the IRA increases the amount of section 45Q credits for industrial facilities and power plants to $85/metric ton for QCO stored in geologic formations, $60/metric ton for the use of captured carbon emissions, and $60/metric ton for QCO stored in oil and gas fields. With respect to direct air capture projects, the IRAincreases the credit to $180/metric ton for projects that store captured QCO in secure geologic formations, $130/metric ton for carbon utilization, and $130/metric ton for QCO stored in oil and gas fields. The changes in the amount of the credit appkies to facilities or equipment placed in service after December 31, 2022.

The IRA also decreases the minimum annual QCO capture requirements for credit eligibility to 1,000 metric tons (from 100,000 metric tons) for direct air capture facilities, 18,750 metric tons (from 500,000 metric tons) of QCO for an electricity generating facility that has a minimum design capture capacity of 75% of "baseline carbon oxide" and 12,500 metric tons (from 100,000 metric tons) for all other facilities. These changes to the minimum capture requirements apply to facilities or equipment that begin construction after the date of enactment.

4. *Introduction of zero-emission nuclear power production credit*

The IRA introduces, as new section 45U, a credit for zero-emission nuclear power production.

The credit for a taxable year is the amount by which 3 cents multiplied by the kilowatt hours of electricity produced by a taxpayer at a qualified nuclear power facility and sold by the taxpayer to an unrelated person during the taxable year exceeds the "reduction amount" for that taxable year.[6]

In addition, a taxpayer is entitled to increase this base credit by 500% if it meets the prevailing wage requirements.

New section 45U applies to taxable years beginning after December 31, 2032.

5. *Biodiesel, Alternative Fuels, and Aviation Fuel Credit*

The IRA extends the pre-IRA tax credit for biodiesel and renewable diesel at $1.00/gallon and the pre-IRA tax credit for alternative fuels at $.50/gallon through the end of 2024. Additionally, the IRA creates a new tax credit for sustainable aviation fuel of between $1.25/gallon and $1.75/gallon. Eligibility for the aviation fuel credit depends on whether the aviation fuel reduces lifecycle greenhouse gas emissions by at least 50%, which corresponds to a $1.25/gallon credit (with an additional $0.01/gallon for each percentage point above the 50% reduction, resulting in a maximum possible credit of $1.75/gallon). This credit applies to sales or uses of qualified aviation fuel before the end of 2024.

6. *Introduction of clean hydrogen credit*

The IRA introduces, as new section 45V, a clean hydrogen production tax credit. To be eligible, a taxpayer must produce the clean hydrogen after December 31, 2022 in facilities whose construction begins before January 1, 2033.

The credit for the taxable year is equal to the kilograms of qualified clean hydrogen produced by the taxpayer during the taxable year at a qualified clean hydrogen production facility during the ten-year period beginning on the date the facility was originally placed in service, multiplied by the "applicable amount" with respect to such hydrogen.[7]

The "applicable amount" is equal to the "applicable percentage" of $0.60. The "applicable percentage" is equal to:

- 20% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate between 2.5 and 4 kilograms of CO_2e per kilogram of hydrogen;
- 25% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate between 1.5 and 2.5 kilograms of CO_2e per kilogram of hydrogen;
- 4% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate between 0.45 and 1.5 kilograms of CO_2e per kilogram of hydrogen; and
- 100% for qualified clean hydrogen produced through a process that results in a lifecycle greenhouse gas emissions rate of less than 0.45 kilograms of CO_2e per kilogram of hydrogen.

A taxpayer is entitled to increase this base credit by 500% if (i) it meets the prevailing wage and apprenticeship requirements or (ii) it meets the prevailing wage requirements, and its facility begins construction within fifty-nine days after the Secretary publishes guidance on the prevailing wage and apprenticeship requirements.

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[1] All references to section are to the Internal Revenue Code.

[2] The IRA defines "foreign-parented multinational group" as a group of two or more entities in a taxable year, in which (i) at least one is a domestic corporation and the other is a foreign corporation, (ii) the entities are included in the same applicable financial statement for the taxable year, and (iii) either (a) their common parent is a foreign corporation or (b) if there is no common parent, they are treated as having a common parent that is a foreign corporation under rules to be prescribed by the Secretary.

To determine whether a foreign-parented multinational group exists, the IRA treats a foreign corporation's trade or business as a separate, wholly-owned domestic corporation.

[3] A surrogate foreign corporation is a foreign corporation (i) that has acquired substantially all of the properties held directly or indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership; (ii) the acquisition of at least 60% of the stock (by vote or value) of the entity is held, (a) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation, (b) in the case of an acquisition with respect to a domestic partnership, by former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership or (c) in the case of an acquisition with respect to a domestic partnership, by former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership; and (iii) after the acquisition the "expanded affiliated group" which includes the entity does not have substantial business activities in the foreign country in which, or under the law of which, the entity is created or organized, when compared to the total business activities of such expanded affiliated group.

[4] The IRA requires new prevailing wage and apprenticeship requirements to be satisfied in order for a taxpayer to be eligible for increased credits. To satisfy the prevailing wage requirements, a taxpayer is required to ensure that any laborers and mechanics employed by contractors or subcontractors to construct, alter or repair the taxpayer's facility are paid at least prevailing local wages with respect to those activities. To satisfy the apprenticeship requirements, "qualified apprentices" are required to construct a certain percentage of the taxpayer's facilities (10% for facilities whose construction begins before January 1, 2023 and 15% for facilities whose construction begins on January 1, 2024 or after). A "qualified apprentice" is a person employed by a contractor or subcontractor to work on a taxpayer's facilities and is participating in a registered apprenticeship program.

[5] An "energy community" is a brownfield site; an area which has (or had at any time after December 31, 1999) significant employment related to the extraction, processing, transport, or storage of coal, oil, or natural gas; and a census tract in which a coal mine closed or was retired after December 31, 1999 (or an adjoining census tract).

[6] A “qualified nuclear power facility” is any nuclear facility that is owned by the taxpayer, that uses nuclear energy to produce electricity, that is not an “advanced nuclear power facility” as described in section 45J(d)(1), and is placed in service before the date that new section 45U is enacted.

“Reduction amount” is, for any taxable year, the amount equal to (x) the lesser of (i) the product of 3 cents multiplied by the kilowatt hours of electricity produced by a taxpayer at a qualified nuclear power facility and sold by the taxpayer to an unrelated person during the taxable year and (ii) the amount equal to 80% of the excess of the gross receipts from any electricity produced by the facility (excluding an advanced nuclear power facility) and sold to an unrelated person during the taxable year; (y) over the amount equal to the product of 2.5 cents multiplied by the kilowatt hours of electricity produced by the taxpayer at a qualified nuclear power facility and sold by the taxpayer to an unrelated person during the taxable year.

[7] “Qualified clean hydrogen” is hydrogen that is produced (i) through a process that results in a lifecycle greenhouse gas emissions rate of no more than 4 kilograms of CO_2e per kilogram of hydrogen, (ii) in the United States, (iii) in the ordinary course of the taxpayer’s trade or business, (iv) for sale or use, and (v) whose production and sale or use is verified by an unrelated party. The IRA does not explain what “verified by an unrelated party” means.

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