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Client Alert

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The Inflation Reduction Act Clears the Senate

House Passage and President Biden's Signature Expected This Week

On Sunday, August 7, following an all-night voting session, the Senate approved the Inflation Reduction Act (IRA) by a vote of 51-50. The IRA was considered under the budget reconciliation procedure, requiring only a simple majority to pass the bill; Vice President Harris cast the tie-breaking vote. Republicans introduced dozens of amendments, most of which failed on party-line votes. A few Democrats offered amendments that ultimately failed as well, as Democratic leaders were concerned that inclusion of broader amendments would jeopardize the overall legislative package.

Senate passage of the IRA comes after more than a year of Democratic negotiations over the size and scope of domestic policy package that could pass an evenly divided Senate and win the support of the slim majority in the House of Representatives. The $700 billion bill that passed the Senate includes policies related to taxes, climate change, prescription drug pricing, and Affordable Care Act (ACA) subsidies.

The House is expected to be in session on Friday, August 12, to consider the Senate-passed IRA. The House is anticipated to approve the legislation, clearing it for President Biden's signature and enactment into law.

Highlights of the reconciliation legislation are below; the full text of the IRA can be found here.

TAX PROVISIONS

The tax provisions in the reconciliation package include two main components focused on re-building the IRS and imposing a 15% Corporate Minimum Tax. By investing $80 billion over the next ten years for tax enforcement and compliance, the Congressional Budget Office estimates the IRS will collect $203 billion. The 15% minimum tax on approximately 200 of the largest corporations will raise $313 billion.

Senator Kyrsten Sinema (D-AZ) succeeded in including language to remove provisions that would have changed the taxation of carried interest. Additionally, Senate Minority Whip John Thune (R-SD) included an amendment to exempt businesses owned by private equity from the new corporate minimum tax, paid for with a one-year extension of a cap on State and Local Tax deductions.

Corporate Alternative Minimum Tax

This legislation imposes a new minimum tax of 15% on corporations based on financial statement income. The minimum tax applies to taxable years beginning after December 31, 2022.

The minimum tax will apply to corporations with $1 billion or more in average annual earnings in the previous three years, determined on a combined basis for groups of corporations under common control. This provision imposes the minimum tax in tax years after 2022 on the income corporations report on their financial statements, or “book income,” with some adjustments. One important adjustment, which mitigates the effect of the minimum tax somewhat, redetermines financial statement income using accelerated tax depreciation instead of book depreciation.

Subchapter S corporations, regulated investment companies (RICs), and real estate investment trusts (REITs) are excluded. For U.S. corporations that have foreign parents, the minimum tax applies only to income earned in the United States of $100 million or more of average annual earnings in the previous three years (if the international financial reporting group has income of $1 billion or more).

Domestic credits under the general business tax will be allowed to offset up to 75% of the combined regular and minimum tax. Foreign tax credits will be allowed against the minimum tax for foreign taxes that are paid or accrued for US tax purposes and reflected in a corporation’s financial statement. Under the minimum tax, as much as 80% of losses can be carried over to offset financial income in future years.

Stock Repurchases

The bill imposes a 1% excise tax on the fair market value of any stock repurchase in a tax year by a publicly traded US corporation, including any 50% or more owned subsidiary. Publicly traded corporations often purchase their own shares as an alternative way to distribute income to shareholders, with a lower tax rate compared to dividend distributions. The tax also applies to stock repurchases of certain foreign corporations by U.S. subsidiaries and “expatriated entities.” The tax will take effect in 2023. It exempts a repurchase of stock that is or was, as the case may be:

- Less than $1 million;
- Contributed to an employer-sponsored retirement plan, stock ownership plan, or similar plan;
- Part of a reorganization with no gain or loss recognized;
- Made by a regulated investment company or a real estate investment trust; or
- Treated as a dividend.

IRS Funding

The legislation appropriates the following amounts for the IRS in fiscal year 2022, with funds remaining available through fiscal year 2031:

- $45.6 billion for tax enforcement activities, including legal and litigation support, criminal investigations, and digital asset monitoring and compliance activities.

- $25.3 billion for operations support, including rent payments, facilities services, other IRS-wide administration activities, research and statistics of income, and information technology development.
- $4.75 billion for business systems modernization to provide more personalized customer service.

ENERGY AND CLIMATE CHANGE PROVISIONS

The legislation has $369 billion of climate and clean energy provisions, including incentives for renewable energy, energy storage, carbon capture and sequestration, hydrogen, nuclear, biofuels, and electric vehicles. The bill also contains $60 billion for environmental justice initiatives and provides incentives for substantial investments in rural communities.

Energy

The bill substantially rewrites the incentives for renewable energy and climate change mitigation under the tax code.

New tax credits will generally replace the production tax credit (PTC) and investment tax credit (ITC) for projects that begin construction in 2025 or later. Projects on which construction begins before January 1, 2025 may still qualify for the existing PTC and ITC, and the bill extends the life of those credits in some but not all cases. Many of these credits were set to expire at the end of 2023 for projects that had not yet begun construction. In some cases, the bill retroactively extends credits that have already expired under current law. The bill also broadens the scope of the PTC and ITC credits to cover new categories of projects.

In addition, the bill creates a number of new tax credits. Some of these, such as the new sustainable aviation fuel credit, will terminate as of January 1, 2025. Others will remain in effect with a variety of termination dates, phase-out provisions, and commencement of construction requirements.

New Zero-Emission Electricity Tax Credits Beginning in 2025

With limited exceptions, projects that begin construction in 2025 or later will not be eligible for PTCs or ITCs. In their place:

- The bill creates a “clean electricity production credit” (CEPC) and a “clean electricity investment credit” (CEIC), both for electric generating facilities placed in service after 2024 that have a lifecycle “greenhouse gas emissions rate” of zero or less. The concept of lifecycle greenhouse gas emissions is defined by reference to Section 211 of the Clean Air Act. These credits are “technology neutral”: they are theoretically available regardless of how the electricity is generated, based entirely on the lifecycle emissions analysis. The analysis may include the effect of technologies such as carbon capture and sequestration (CCS) where applicable, unless other tax incentives have been claimed for the property in question (e.g., CCS equipment on which Section 45Q credits have been claimed).
- The CEPC will apply to electric generating facilities for 10 years from the date they are placed in service.
- Unlike the PTC, which requires a sale of electricity to an unrelated person, the CEPC will also apply to electricity used or stored by the producer or sold to a related person, in each case if the meter measuring the electricity is owned and operated by an unrelated party.
- For combined heat and power projects, the CEPC will be available for “useful thermal energy.” The amount of the credit will be based on the electric power equivalent of the useful thermal energy.

- The CEIC will apply to electric generating facilities and to energy storage technology property, including standalone storage projects. For projects generating five MW (AC) or less, the CEIC will also apply to investments in "qualified interconnection property." These are payments to an electric utility under an interconnection agreement for upgrades it makes to the distribution system to add the project to the electric distribution network.
- Both the CEPC and the CEIC are subject to a phase-out provision that will be triggered if total US greenhouse gas emissions from electricity production fall to 25% of 2022 levels. If that occurs, the credits will be reduced by 25% for projects that begin construction in the second calendar year thereafter (but not before 2034) and by 50% for projects that begin construction in the third calendar year thereafter (but not before 2035). Projects that begin construction after 2035 and more than three calendar years after the trigger is met will not qualify for credits.

Reduction in Base Credit Amounts, Potentially Offset if Certain Labor Conditions Are Met

The baseline credit amount under both the new tax credits and the current PTC and ITC is generally reduced to 20% of the amount provided under current law. The bill provides, however, that the applicable credit in each case is five times the baseline amount (and thus equal to the amount under current law) for projects that meet or are exempted from two new labor-related conditions:

- The prevailing wage requirement is met if the laborers and mechanics who construct or repair the project, including those employed by contractors and subcontractors, receive wages at least equal to the prevailing market wage for the relevant locality of the project as determined by the Secretary of Labor. (This is the same requirement imposed on federal contractors under the Davis-Bacon and Related Acts.)
- The apprenticeship requirement is generally met if a specified amount of construction, alteration, and repair work on the project, including work done by contractors and subcontractors, is performed by qualified apprentices under the National Apprenticeship Act. The threshold phases in over time, from 10% of labor hours for projects that begin construction in 2022 to 15% of labor hours for projects that begin construction in 2024 or later. Additional conditions may apply, including under rules promulgated by the Department of Labor and state apprenticeship agencies as well as Treasury regulations and IRS guidance.
- The owner of a project can cure failures to meet these requirements by paying a penalty (and, in the case of the prevailing wage requirement, making up the shortfall with interest to the underpaid workers).
- The requirements apply to projects that begin construction 60 days or more after the IRS issues guidance interpreting them. They do not apply to projects that begin construction before then, nor to projects with a capacity less than one MW (AC).

Bonus Tax Credits for Domestic Content and Certain Disadvantaged Communities

ITC- and PTC-eligible projects, as well as projects eligible for the CEPC and CEIC, are eligible for an additional 10% bonus if the project meets certain domestic content thresholds in the construction phase or if the project is located in an "energy community." The Act defines "energy communities" as including brownfield sites, areas with significant employment (post-1999) related to extraction, processing, transport, or storage of coal, oil or natural gas, or any census tract (or adjoining tract) that had either a coal mine close after 1999 or coal-fired electric generating unit retire after 2009. The Act also would include certain phase-out provisions for the domestic content rules, as well as other ancillary provisions. Projects can qualify both the domestic content and the project location bonuses.

Extension and Expansion of Energy Tax Credits

The bill extends the PTC and ITC for projects in a number of categories to cover projects on which construction commences before January 1, 2025, including wind, solar, geothermal, and biomass projects. It also expands the ITC to cover a number of new categories of property. These new ITC categories include, among other things:

- Energy storage property, including technologies that store energy for conversion to electricity and technologies that store thermal energy for use in an HVAC system;
- Biogas (RNG) projects that convert biomass to methane for sale or productive use. (Under current law, some projects may qualify for PTCs. They can elect ITCs instead of PTCs, but only at 50% of the usual ITC rate.);
- Fuel cells using electromechanical processes in addition to those that use electrochemical processes;
- Electrochromic glass; and
- Qualified interconnection property for projects of 5 MW or less, as described in the discussion of CEICs above.

The bill does not, however, provide tax credits for standalone electric transmission infrastructure.

The bill revives the PTC for solar electricity projects, which currently qualify for ITCs only. (The solar PTC expired in 2006.) Under the bill, qualifying solar projects that begin construction before January 1, 2025 will be able to elect either the PTC or the ITC.

Conversely, qualifying wind energy projects that begin construction before January 1, 2025 will be able to elect the ITC instead of the PTC on the same basis as other qualifying energy property. Prior to the expiration of the wind energy PTC in 2021, wind projects could elect to claim ITCs instead of PTCs, but the credit rate was reduced by 40% for projects that began construction after 2017 (60% for projects that began construction in 2019).

Other New Tax Credits

The bill creates new tax credits for nuclear power production (Section 45U) and production of clean hydrogen (defined as hydrogen with lifecycle GHG emissions of 4 kilograms or less CO_2 equivalent per kilogram of hydrogen produced). Project sponsors may elect a 30% ITC instead of the new credit, which is subject to a similar sliding scale reduction. The clean hydrogen credit is addressed in more detail in a separate King & Spalding Client Alert.

These credits are subject to the prevailing wage and apprenticeship rules discussed above.

Carbon Capture and Storage

The bill extends the tax credits under Section 45Q for carbon capture and sequestration to projects beginning construction prior to January 1, 2033. It also reduces the minimum capture thresholds required to qualify for the credit, and significantly increases the credit value per metric ton of CO_2, especially for direct air capture projects and

projects that do not use the captured CO_2 for enhanced oil recovery or other commercial purposes, as shown in the following table:

Carbon Capture Technology (CO_2 use)	Tax Credits (\$/metric ton CO_2)	
	Current Law	Inflation Reduction Act
Industrial Source (utilized, e.g. for enhanced oil recovery)	up to \$35	up to \$60
Industrial Source (direct sequestration)	up to \$50	up to \$85
Direct Air Capture (utilized)	up to \$35	up to \$130
Direct Air Capture (direct sequestration)	up to \$50	up to \$180

Direct Pay and Transferability of Credits

In a significant shift from the current law, the bill provides for a "direct pay" election in certain circumstances, which allows project owners and investors to receive a cash payment in lieu of tax credits. Direct pay is only available to (i) certain tax-exempt investors and state and local governments, and (ii) taxpayers claiming tax credits for carbon sequestration, clean hydrogen, and advanced manufacturing (in each case limited to the first five years of the credit period).

Taxpayers not eligible to elect direct pay can elect to sell or transfer most clean energy tax credits to unrelated parties, which may significantly expand potential financing sources and structures for renewable energy projects. Credits that have been transferred under this provision may not be retransferred by the purchaser.

The carryback period for most credits is extended from one year to three years.

Clean energy manufacturing

The bill also provides \$60 billion in incentives to bring clean energy manufacturing into the U.S. These include production tax credits to accelerate U.S. manufacturing of solar panels, wind turbines, batteries, and critical minerals processing. Investment credits to build clean technology manufacturing plants that make electric vehicles, turbines and other products are also included.

Electric Vehicles

The bill extends the \$7,500 per vehicle consumer tax credit for the purchase of new electric vehicles and up to \$4,000 for the purchase of a used electric vehicle. To qualify for the tax credit on new cars, however, companies will have to comply with battery and critical minerals U.S. sourcing requirements. The credit is not available for cars that cost more than \$55,000 or trucks and SUVs that cost more than \$80,000.

The bill also creates a new credit for qualified commercial clean vehicles, which comprise commercial vehicles and mobile machinery that are powered either to a significant extent by a plug-in battery or by a fuel cell. The credit is equal to the lesser of 15% of the vehicle's tax basis (or 30%, if the vehicle does not have a combustion engine) and the excess of the purchase price of such vehicle over that of a comparable non-clean vehicle. It is capped at \$7,500 for vehicles with a gross vehicle weight rating of less than 14,000 pounds and \$40,000 for all other qualified vehicles.

The credit for alternative-fuel vehicle refueling property under Section 30C is expanded to include bidirectional charging equipment and charging infrastructure for two- and three-wheeled electric vehicles. The credit now applies per refueling property item (rather than per location) and the cap for each item of refueling property has been increased to \$100,000.

Other Consumer and Energy Efficiency Incentives

Tax credits are included for consumers who add renewable energy items to their homes, including efficient heat pumps, rooftop solar, electric HVAC and water heaters. $9 billion is included for home energy rebate programs for low-income consumers and $1 billion in grants for affordable housing energy upgrades.

Greenhouse Gas Reduction Fund

A new Greenhouse Gas Reduction Fund is funded at $27 billion over the next 10 years to leverage private sector investment and community lenders to build wind, solar, electric vehicle, and energy projects at the community level.

Biofuels

$500 million in grants is allocated to expand biofuel infrastructure such as storage tanks and blending facilities. Certain existing income and excise tax credits for biodiesel, renewable diesel, alternative fuels, SAF and second-generation biofuels are extended to 2024.

Oil and Gas

Leasing

The bill requires the Interior Department to offer at least 2 million acres a year for onshore oil and gas lease sales. Unless those lease sales are held, the Department cannot offer rights of way for solar and wind power projects.

Methane

The bill includes a fee of up to $1,500 a ton for methane gas emissions. The legislation gives companies time and money to install equipment to monitor and cut emissions.

Environmental Justice Funding

The legislation includes over $60 billion in environment justice priorities including: $3 billion for Environmental and Climate Justice Block Grants; $3 billion for Neighborhood Access and Equity Grants; $3 billion for grants to reduce air pollution at ports; and $1 billion for clean heavy-duty trucks. In addition, many of the clean energy tax credits include either a bonus or set-aside structure to drive investments and economic development in disadvantaged communities.

Rural Communities

The legislation provides more than $20 billion to support climate-smart agricultural practices; $5 billion to support fire resilient forests, forest conservation and urban tree planting; and $2.6 billion in grants to conserve and restore coastal habitats.

HEALTH PROVISIONS

Prescription Drug Pricing Reform

The IRA fulfills a longstanding Democratic promise to authorize prescription drug price negotiation for the Medicare program. Specifically, the Secretary of Health and Human Services (HHS) would be required to establish a Drug Price Negotiation Program, under which the Secretary would publish a list of selected high-cost prescription drugs, enter into agreements with manufacturers of those drugs, and then negotiate and re-negotiate as necessary a “maximum fair price.” HHS would be required to identify 100 brand drugs covered under Medicare Part B and Medicare Part D that have been on the market for seven years in the case of drugs and 11 years in the case of

biologics, as well as have the highest spending under Medicare. There will be 10 negotiation-eligible drugs in 2026, 15 drugs in 2027 and 2028, and 20 drugs in 2029.

The IRA restructures the Part D prescription drug benefit and caps Medicare beneficiaries' Part D out of pocket costs at $2,000 per year, which beneficiaries may spread over monthly payment installments. The bill holds Medicare part D annual premium growth to existing levels and expands the population of Part D patients who are eligible for premium and co-pay assistance on prescription drugs.

Drug companies would be required to rebate the difference to Medicare if manufacturers raise prices higher than the rate of inflation. The rebate applies only to purchases by Medicare. (The bill was amended to remove a provision that would have included commercial sales in the amount of the rebate, which the Senate Parliamentarian ruled could not be adopted under the reconciliation process.)

A $35 per month out-of-pocket cap is included for insulin for Medicare beneficiaries. (While the IRA originally included a $35 per month insulin cap for both Medicare beneficiaries and individuals with private insurance, a bipartisan group of Senators was unable to muster the 60 votes needed to override a point of order raised by Republicans to strike the inclusion of private insurance in the cap on insulin prices.)

Extension of ACA Subsidies

The IRA extends through 2025 the Affordable Care Act (ACA) premium subsidies, originally expanded as part of the American Rescue Plan (ARP) in 2021. Specifically, the ARP extended the ACA premium tax credits to 400% of the federal poverty line, allowing individuals who purchased insurance under the program to not pay more than 8.5% of their income on coverage. Without the IRA extension, ACA subsidies would expire at the end of 2022.

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