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U.S. Senate Passes Inflation Reduction Act

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On August 7, after weeks of negotiations, the Senate voted 51-50 to pass a budget reconciliation package known as the Inflation Reduction Act (the "**Bill**"), introduced by Senators Joe Manchin (D-WV) and Chuck Schumer (D-NY) in late July. The Bill includes significant tax reform provisions and proposes many new and modified clean energy tax incentives.

Highlights of the Bill include the following:

Corporate Tax

Corporate Alternative Minimum Tax

The Bill implements a 15% alternative minimum tax (the "**AMT**") on the adjusted financial statement income of any corporation (excluding S corporations, regulated investment companies, and real estate investment trusts) with an average annual adjusted financial statement income over $1 billion for the prior three tax years, beginning in tax years that begin after December 31, 2022. This AMT would also apply to foreign-parented corporations with adjusted financial statement income over $1 billion whose three-tax-year average annual adjusted financial statement income exceeds $100 million. Corporations subject to the AMT would be permitted to use net operating losses incurred after December 31, 2019 against up to 80% of their AMT liability and tax credits to offset up to 75% of their AMT liability. The Senate also passed an amendment to the Bill, introduced by Senator John Thune (R-SD), which allows the $1 billion threshold to be determined without reference to the income of unrelated businesses under shared ownership, which would protect many portfolio companies of private equity firms from this new AMT.

Excise Tax on Repurchase of Corporate Stock

The Bill imposes a new 1% excise tax on publicly traded U.S. corporations that repurchase their shares directly or through a "special affiliate"—*i.e.*, a corporation whose stock or a partnership whose interests are more than 50% directly or indirectly owned by the publicly traded corporation—after December 31, 2022. This new excise tax does not apply if (a) the repurchase is part of a reorganization under Code Section 368(a); (b) the repurchased stock, or any amount equal to the repurchased stock, is contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan; (c) the total value of the repurchased stock in a taxable year does not exceed $1 million; (d) the repurchase is by a dealer in securities in the ordinary course of business; (e) the repurchase is by a regulated investment company or a real estate investment trust; or (f) the repurchase qualifies as a dividend.

IRS Funding

The Bill authorizes the appropriation of approximately $80 billion to the IRS, to remain available until 2031. This includes $3.2 billion to provide taxpayer services, $45.6 billion for tax enforcement activities, $25.3 billion to support taxpayer services and enforcement programs (including services, operations, and maintenance for IRS facilities and administration activities), and $4.8 billion for IRS business systems modernization programs.

Additional Non-Energy Tax Provisions

Extension of Limitation on Deducting Excess Business Losses

An amendment to the Bill introduced by Senator Mark Warner (D-VA) extends the expiration of the limitation on the deductibility of excess business losses under Code Section 461(l)(1) from January 1, 2027 to January 1, 2029.

Affordable Care Act

The Bill extends the Affordable Care Act enhanced premium tax credit from the end of 2022 through the end of 2025.

Section 41 Research Tax Credit

The amendment to the Bill introduced by Senator Mark Warner (D-VA) also increases the Code Section 41 research credit against payroll taxes for small businesses.

Energy Incentives

Extension and Modification of the PTC and ITC

The Bill extends the existing production tax credit under Code Section 45 (the "PTC") and the investment tax credit under Code Section 48 (the "ITC") for facilities that begin construction before January 1, 2025. In addition to the existing eligible technologies, which include wind, hydropower, biomass, and municipal solid waste, the Bill reinstates the PTC for solar facilities and extends it for geothermal facilities. The base PTC rate amount is 0.3 cents and the base ITC rates are 6% (for fuel cell, qualified small wind, waste energy recovery, and solar energy property) and 2% (for all other energy properties), with a bonus PTC rate amount of 1.5 cents and a bonus ITC rate of 30% for facilities with a maximum output of less than 1MW or that meet prevailing wage and apprenticeship requirements, discussed below. The current phase-downs for the ITC and the PTC will be removed for any projects placed in service after December 31, 2021. Following December 31, 2024, the PTC and ITC will switch to a clean electricity version, discussed below.

Clean Electricity PTC and ITC. The Bill provides for an emission-based, technology-neutral PTC or ITC for the production of clean energy for facilities with zero or net-negative carbon emissions that begin construction before January 1, 2033 and that are placed in service after December 31, 2024. The base PTC rate amount is 0.3 cents and the base ITC rate is 6%, with a bonus PTC rate amount of 1.5 cents and a bonus ITC rate of 30% for facilities with a maximum output of less than 1MW or facilities that satisfy the prevailing wage and apprenticeship requirements. These base credit amounts are increased for facilities meeting domestic content requirements and, in the case of the ITC, for certain facilities located in low-income communities. The ITC is subject to recapture if the greenhouse gas emission rate for a facility is greater than 10 grams of CO_2e per KWh. In addition, the technology-neutral PTC and ITC will begin to phase out for facilities beginning construction in the first calendar year after the later of (a) 2032 or (b) the calendar year in which the IRS determines that the annual greenhouse gas emissions from the production of electricity in the United States are equal to or less than 25% of the annual greenhouse gas emissions from the production of electricity in the United States for calendar year 2022. In the three calendar years beginning with the applicable year, the PTC or ITC is reduced to 100%, 75%, and 50% of the base rate, respectively, after which the PTC and ITC are no longer available.

Prevailing Wage and *Apprenticeship Requirements*. Generally, facilities will only qualify for the full credit rates if (a) all laborers and mechanics employed at the facility or any contractors or subcontractors employed to construct, alter, or repair the facility are paid wages at prevailing rates, as determined by the Secretary of Labor, and (b) no fewer than an applicable percentage of total labor hours of the construction, alteration, or repair work with respect to the facility are performed by qualified apprentices. There is an exception to this rule for facilities that have not been placed in service before January 1, 2022 and that have begun construction before the date that is 60 days after the IRS issues additional guidance with respect to prevailing wage and apprenticeship; such facilities are not subject to the prevailing wage and apprenticeship requirements and may qualify for the full credit rates.

Energy Storage. The Bill adopts a stand-alone ITC for energy storage facilities with a capacity of at least 5 kWh. In addition, the Bill provides that service contracts with respect to energy storage facilities are exempt from the Code Section 7701(e) rule that re-characterizes certain service contracts as leases.

Interconnection Property. The Bill adopts a new ITC for interconnection equipment less than 5 MW in size that is part of an addition, modification, or upgrade to a transmission or distribution system required beyond the point at which a facility interconnects to that system to accommodate the interconnection.

Bonus PTC and ITC for Domestic Content and Energy Communities. For facilities placed in service after December 31, 2022, (a) the base PTC or ITC amount is increased by 10% or 2%, respectively, for facilities in which at least 40% (20% in the case of offshore wind facilities) of the total cost of the components incorporated into the facility are mined, produced, or manufactured in the United States, and (b) the base PTC or ITC amount is increased by 10% (for the PTC and for ITC facilities that also meet the domestic content requirement) or 2% (for ITC facilities that do not meet the domestic content requirement) for facilities located in an "energy community," which is defined to include brownfield sites, areas with significant employment relating to coal, oil, or natural gas, and areas with retired coal-fired power plants).

Increased ITC for Investments in Low-Income Communities. Facilities that receive an allocation of environmental justice solar and wind capacity limitation (as determined by the Secretary of the Treasury) may receive an additional 10% ITC amount if they are located in a low-income community or on Indian land, or an additional 20% ITC amount if they are part of a qualified low-income residential building project or qualified low-income economic benefit project.

Tax-Exempt and Government Financing. For facilities that begin construction after the date of enactment of the Bill, the PTC and ITC are reduced by a maximum of 15% when tax-exempt bonds are used, but the Bill removes the reduction of the tax credit for other government financing.

Cost Recovery for Qualified Facilities. Effective for facilities placed in service after December 31, 2024, facilities and property qualifying for the clean electricity PTC and ITC and energy storage technology shall be treated as 5-year property for MACRS depreciation recovery periods.

Coordination with Low-Income Housing Tax Credit. For purposes of determining the adjusted basis of a project eligible for the low-income housing tax credit under Code Section 42, the rule requiring the basis of property be reduced by 50% of the ITC does not apply.

Extension of Carbon Capture Credit

The Bill extends the credit for carbon-capture sequestration facilities under Code Section 45Q to facilities that are placed in service after December 31, 2021, and before January 1, 2033, and lowers the minimum carbon-capture requirements for treatment as a qualified facility. The carbon capture credit may also be claimed as a direct payment.

New Energy Incentive Credits

Nuclear Power Production Credit. The Bill creates a new PTC for the production of electricity from a qualified nuclear facility (other than those that have claimed a credit for advanced nuclear power facilities under Section 45J). The credit applies to electricity produced and sold to an unrelated person after December 31, 2023 and before January 1, 2033. A bonus credit is available for facilities satisfying the prevailing-wage and apprenticeship requirements, described above.

Clean Hydrogen Production Credit. The Bill also creates a new PTC or ITC for the production of clean hydrogen at a qualified clean hydrogen facility in the United States. To qualify for the credit, the construction of the facility must have begun before January 1, 2033. A bonus credit is available for facilities satisfying the prevailing-wage and apprenticeship requirements, described above. This credit may also be claimed as a direct payment.

New Manufacturing Credits

The Bill creates a new advanced manufacturing PTC for "eligible components" that are produced and sold to an unrelated person after December 31, 2022. Eligible components include photovoltaic cells, solar modules, wind energy components, and battery cells, among other components, and the credit amount varies depending on the component produced. The credit will begin phasing out after December 31, 2029.

Direct Payments

For taxable years beginning after December 31, 2022 and before January 1, 2033, taxable businesses may elect to receive the carbon capture credit, the clean hydrogen production credit, and the advanced manufacturing production credit through direct payment in lieu of a credit. In the case of a facility owned by a partnership or S corporation, this election must be made at the entity level and must be made by the due date of the taxpayer's tax return on which the credit must be claimed. Tax-exempt entities and governments have a broader ability to elect the direct pay option for the ITC and PTC.

Transfer of Credits

The Bill permits taxpayers to transfer all or any portion of an applicable PTC or ITC to an unrelated party after December 31, 2022. Any consideration paid in respect of the transferred credit must be paid in cash, and a 20% penalty may apply if the claimed credit amount is excessive. Compensation received by the transferor in connection with the transfer would not be taxable and the transferee could take no expense deduction. In the case of a facility owned by a partnership or S corporation, this election must be made at the entity level and must be made by the due date of the return for the year in which the credit is determined. Nevertheless, transferred credits may be carried back for three years or carried forward to the earliest of the succeeding 22 taxable years. Once the credit is transferred, the transferee could not further transfer the credit. Credits that were carried back or carried forward could not be transferred.

The House of Representatives is scheduled to return from its recess on August 12, and it is expected to approve the Bill. President Biden released a statement that he looks forward to signing the Bill into law.

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