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2022 Inflation Reduction Act (Businesses)

Dear Friends and Clients,

On August 16, 2022, President Biden signed into law the 2022 Inflation Reduction Act (the Act), a major tax/healthcare/climate bill that includes numerous provisions affecting businesses.

Much of the Act is paid for by a minimum tax on corporations with more than $1 billion in income, a one-percent excise tax on corporate stock buybacks, increased IRS enforcement of tax laws, and an extension on the limitation for noncorporate taxpayers of deductions of excess farm losses and excess business losses.

These new taxes help pay for an array of tax credits aimed at reducing carbon emissions and promoting energy efficiency. With respect to these incentives, the Act generally provides two different credit values: a base rate and an alternative, or bonus rate. The bonus rate equals five times the base rate and applies to projects that meet certain wage and apprenticeship requirements. A taxpayer must satisfy both requirements to receive the bonus credit rate. Otherwise, taxpayers may claim the relevant credit at the base rate.

Under the wage requirements, taxpayers must ensure that laborers and mechanics are paid prevailing wages during the construction of a qualifying project, and, in some cases, for the alteration and repair of the project for a defined period after the project is placed into service.

The Act also contains domestic content requirements which require that, with respect to the project for which a tax credit is claimed, the taxpayer must ensure that any steel, iron, or manufactured product that is part of the project at the time of completion was produced in the United States. The domestic content requirements generally apply for purposes of the production and investment tax credits.

The following is a summary of the Act's key energy incentives.

Energy Efficient Commercial Buildings Deduction

The Act updates and expands the energy efficient commercial buildings deduction, starting in 2022, by increasing the maximum deduction, determined on a sliding scale. It also changes this maximum from a lifetime cap to a 3-year cap. The provision updates the eligibility requirements so that property must reduce associated energy costs by 25 percent or more in comparison to a building that meets the latest American Society of

Heating, Refrigerating, and Air-Conditioning Engineers 90.1 standard affirmed by the Treasury Secretary as of 4 years prior to the date such building is placed into service.

This provision allows taxpayers to elect to take an alternative, parallel deduction for energy efficient lighting, HVAC, and building envelope costs placed into service in connection with a qualified retrofit plan. The value of the base deduction is determined by the reduction in a building's energy usage intensity (EUI) upon completion of the retrofit, equal to $0.50 per square foot, increased by $0.02 per square foot for every percentage point by which the reduction in EUI exceed 25 percent, not to exceed $1.00 per square foot. The value of the bonus deduction is $2.50 per square foot, increased by $0.10 per square foot for every percentage point by the reduction in EUI exceeding 25 percent against the reference standard, not to exceed $5.00 per square foot. In order to qualify for the alternative deduction, a building retrofit project must reduce a building's EUI by no less than 25 percent.

Clean Vehicle Credit

The Act provides a credit for new clean vehicles placed into service during the tax year. The amount of credit allowed by this provision with respect to a qualified vehicle is equal to a maximum of $7,500 with respect to a vehicle propelled primarily by electricity, with a battery of at least 7 kilowatt hours, or with respect to a hydrogen fuel cell electric vehicle. Eligible vehicles must meet the critical mineral or battery component requirements. Vehicles which meet one of the requirements, but not both, are eligible for a credit of $3,750.

Clean vehicles must be assembled in North America. For calendar years after 2023, a clean vehicle may not contain any battery components which were manufactured by a foreign entity of concern, and, after calendar year 2024, a clean vehicle may not contain any critical minerals that were extracted, processed, or recycled by a foreign entity of concern.

Clean vehicles must also be sold by a qualified manufacturer. A qualified manufacturer is one which enters into written agreement with the Treasury Secretary to ensure each vehicle manufactured meets the requirements of this provision and is labeled with a unique vehicle identification number, and requires the manufacturer to periodically provide such vehicle identification numbers to the Treasury Secretary in such a manner as the Treasury Secretary may prescribe.

No credit is allowed for vehicles by which the manufacturer's suggested retail price exceeds the applicable limitation, which is: (1) $80,000 for vans, SUVs, and pickup trucks; and (2) $55,000 for any other vehicle. This provision generally applies to vehicles placed in service after December 31, 2022.

Credit for Qualified Commercial Clean Vehicles

The Act creates a new credit for qualified commercial electric vehicles placed into service by a business. The amount of credit allowed with respect to a qualified commercial electric vehicle is equal to 30 percent of the cost of the vehicle, up to $7,500 in the case of a vehicle that weighs less than 14,000 pounds, and up to $40,000 for all other vehicles. Tax-exempt entities have the option of electing to receive direct payments. This provision takes effect after December 31, 2022.

Alternative Fuel Refueling Property Credit

The Act extends the alternative fuel vehicle refueling property credit through 2032. Beginning in 2022, the provision expands the credit for zero-emissions charging and refueling infrastructure by providing a base credit of 6 percent and a bonus credit level of 30 percent for expenses up to $100,000 for each charging station or refueling pump installed.

Advanced Energy Project Credit

The Act revives the qualified advanced energy property credit. The provision sets aside $4 billion for qualifying projects in census tracts in which a coal mine or coal power plant has closed and in which no project received a credit allocation in prior years. Under the provision, projects receive a base credit rate of 6 percent of qualified investments in qualified advanced energy projects. To receive a bonus rate of 30 percent, taxpayers must satisfy the prevailing wage requirements for the establishment, expansion, or re-equipping of a manufacturing facility and for five years after the project is placed into service, and satisfy the apprenticeship requirements during the construction of the project.

Under the provision, eligibility for the credit is modified to include projects to establish, expand, or re-equip facilities for the production, manufacturing, or recycling or advanced grid, energy storage, and fuel cell equipment; equipment for the production of low-carbon fuels, chemicals, and related products; renewable energy and energy efficiency equipment; equipment for the capture, removal, use, or storage of carbon dioxide; and advanced light-, medium-, and heavy-duty vehicles and related components and infrastructure. The credit is also allowed for projects to reduce carbon emissions at existing industrial facilities by at least 20 percent.

Credit for Electricity Produced from Certain Renewable Resources

The Act extends the production tax credit (PTC) for five years, for facilities that begin construction before January 1, 2025. The PTC provides a tax credit for each kilowatt of electricity produced from qualifying facilities and sold to an unrelated party. Qualifying resources are generally sources of renewable electricity, including wind, biomass, municipal solid waste (including landfill gas and trash), geothermal, hydropower, and marine and hydrokinetic energy. The provision also revives the PTC for solar energy (previously sunset in 2006) for facilities which begin construction before January 1, 2025.

Energy Investment Tax Credit

The Act extends the application of the energy investment tax credit (ITC), which allows taxpayers to claim a tax credit for the cost of energy property. In most cases, the provision extends the credit for property for which begins construction before January 1, 2025.

The ITC is expanded to include energy storage technology, biogas property, microgrid controllers, dynamic glass, and linear generators. These technologies are eligible for a 6 percent base credit rate or a 30 percent bonus credit rate for any property that begins construction before January 1, 2025.

Businesses may claim an increased credit with respect to energy property placed into service after December 31, 2022, if such property meets the domestic content requirements. The increase is 2 percentage points (or 10 percentage points if the taxpayer meets the prevailing wage and apprenticeship requirements). For any energy property that is placed in service within an energy community, the credit percentage is increased by 2 percentage points (or 10 percentage points if the taxpayer meets the prevailing wage and apprenticeship requirements). An energy community is defined as a brownfield site, an area with significant fossil fuel employment, or a census tract or any immediately adjacent census tract in which, after December 31, 1999, a coal mine has closed, or, after December 31, 2009, a coal-fired electric generating unit has been retired.

The amendments made by this provision generally apply to property placed in service after December 31, 2022, but only to the extent the basis of such property is attributable to the construction, reconstruction, or erection after December 31, 2022. The extension of credits and modification of credit rates (including the higher rates for projects meeting the wage and apprenticeship requirements) apply to property placed in service after December 31, 2021. The modifications to rules relating to tax-exempt bonds apply to property that begins construction after the date of enactment.

Energy Credit for Solar and Wind Facilities Placed in Service in Connection with Low-Income Communities

The Act provides for an enhanced incentive for certain solar and wind facilities. Property eligible for the credit includes energy storage technology related to such solar or wind property. The amount that may be allocated is limited to an annual capacity limitation of 1.8 gigawatts for each of calendar year 2023 and 2024 (zero for calendar years thereafter). Any unused allocations are carried over, increasing the capacity limit for the following year. This provision takes effect on January 1, 2023.

Credit for Carbon Oxide Sequestration

The Act extends the credit for carbon oxide sequestration for facilities that begin construction before the end of 2032. The provision also modifies the minimum capture requirements for qualified facilities and generally applies to facilities or equipment placed in service after December 31, 2022.

Incentives for Biodiesel, Renewable Diesel and Alternative Fuels

The Act extends the income and excise tax credits for biodiesel and biodiesel mixtures at $1.00 per gallon through December 31, 2024. The provision also extends (1) the $0.10-per-gallon small agri-biodiesel producer credit and (2) the $0.50 per gallon excise tax credits for alternative fuels and alternative fuel mixtures through December 31, 2024. This provision applies to fuels sold or used after December 31, 2021.

Second-Generation Biofuel Incentives

The Act extends the second-generation biofuel credit under Code Sec. 40(a) for fuel produced and sold before January 1, 2025, effective for fuel produced and sold after December 31, 2021.

Sustainable Aviation Fuel Credit

The Act provides a new refundable blenders tax credit for each gallon of sustainable aviation fuel sold as part of a qualified fuel mixture. To claim the credit, taxpayers must certify that such fuel reduces lifecycle greenhouse gas emissions by at least 50 percent, determined in accordance with the requirements of the most recent Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) adopted by the International Civil Aviation Organization (ICAO) with the support of the United States, or under any similar methodology which satisfies the criteria under Section 211(o)(11) of the Clean Air Act. Taxpayers must also register with the Treasury Secretary and provide third-party verification that they meet the relevant requirements of the CORSIA scheme (or other similar regime), including reporting and traceability requirements. In addition, the provision terminates the $1.00 tax credit for aviation fuel produced from biodiesel beginning after December 31, 2022. This provision applies for fuel sold or used after December 31, 2022. The credits allowed under this provision expire after December 31, 2026.

Advanced Manufacturing Production Credit

The Act provides a production credit for certain eligible components that are produced and sold. Eligible components include solar polysilicon, wafers, cells, modules, backsheets, longitudinal purlins, and structural fasteners; wind blades, nacelles, towers, and offshore foundations; inverters; battery electrode active materials, cells, and modules; and critical minerals. The credits are provided based on mass, watt-capacity, sales price, or production cost.

Clean Energy Production and Investment Credits

The Act creates an emissions-based incentive that would be neutral and flexible between clean electricity technologies. Taxpayers are able to choose between a production tax credit or an investment tax credit. Any power facility of any technology can qualify for the credits, so long as the facility's carbon emissions are at or below zero.

Cost Recovery for Qualified Facilities, Qualified Property, and Energy Storage Technology

The Act provides that any facility described in the clean electricity production credit and any qualified property or grid improvement property described in the clean electricity investment credit will be treated as 5-year property under the general depreciation system.

Clean Fuel Production Credit

The Act creates a technology-neutral incentive for the domestic production of clean fuels. The level of the incentive depends on the lifecycle carbon emissions of a given fuel. Zero-emission fuels qualify for a base incentive of $0.20 per gallon or gallon equivalent. Sustainable aviation fuel that meets certain American Society for Testing and Materials standards and is not derived from palm oil qualifies for a base incentive of $0.35 per gallon or gallon equivalent.

Qualifying production is restricted to production in the United States of fuel that is used or sold.

Increase in Research Credit Against Payroll Tax for Small Businesses

Under current law, eligible start-up businesses are allowed to elect to claim up to $250,000 of the research credit against their payroll taxes. The Act allows those businesses to claim an additional $250,000 each year against Medicare payroll taxes.

As you can see, there is a lot to unpack with this legislation. Please call me at your earliest convenience so we can discuss how your business may benefit from some of the Act's provisions.

Sincerely,

Hansen Cochrane, Ltd.