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2022 Inflation Reduction Act (Individuals)

Dear Friends and Clients,

On August 16, 2022, President Biden signed into law the 2022 Inflation Reduction Act (the Act). The Act includes numerous tax provisions - most notably an array of new tax credits relating to energy efficient homes, businesses, and vehicles. It also provides several new healthcare and prescription drug benefits for individuals, including a $2,000 Medicare out-of-pocket cap for prescription drugs, a $35 Medicare monthly insulin cap, and a three-year extension of the expanded Affordable Care Act health insurance subsidy.

The following is a summary of the Act's key provisions that may affect you.

Extension and Modification of Plug-In Electric Vehicle Tax Credit (Renamed Clean Vehicle Credit)

While favorable changes to the credits for "clean" vehicles, including a new credit for used vehicles, are a significant part of the legislation, there is also a new requirement that a certain percentage of vehicle components be manufactured or assembled in North America and a provision that vehicles with battery components that were manufactured or assembled by certain foreign entities will not qualify. The Act also imposes new income limits on who can claim the credit as well as price limits based on vehicle type.

Currently, buyers of qualifying plug-in electric vehicles (EVs) are eligible for a nonrefundable tax credit of up to $7,500. The tax credit phases out once a vehicle manufacturer has sold 200,000 qualifying vehicles. Also, through 2021, a tax credit of up to $8,000 was allowed for fuel cell vehicles (the base credit amount was $4,000, with up to an additional $4,000 available based on fuel economy). Heavier fuel cell vehicles qualified for up to a $40,000 credit.

The Act modifies the tax credit for plug-in EVs, allowing certain clean vehicles to qualify and eliminating the current per manufacturer limit. The credit is renamed the clean vehicle credit and the modified credit is $3,750 for any vehicle meeting a critical-minerals requirement, and $3,750 for any vehicle meeting a battery-components requirement. The maximum credit per vehicle is $7,500. Clean vehicles include plug-in EVs with a battery capacity of at least 7 kilowatt hours and fuel cell vehicles. Qualifying vehicles include those that had their final assembly occur in North America. Sellers are required to provide taxpayer and vehicle information to the Treasury Department for tax credit eligible vehicles. Only vehicles made by qualified manufacturers, who have written agreements with, and provide periodic reports to, the Treasury Department qualify.

For vehicles placed in service after 2023, qualifying vehicles do not include any vehicle with battery components that were manufactured or assembled by certain foreign entities. For vehicles placed in service after 2024, qualifying vehicles do not include any vehicle in which applicable critical minerals in the vehicle's battery are from certain foreign entities. Taxpayers must include the vehicle identification number (VIN) on their tax return to claim a tax credit.

To receive the $3,750 critical-minerals portion of the credit, the vehicle's battery must contain a threshold percentage (in value) of critical minerals that were extracted or processed in a country with which the United States has a free trade agreement, or recycled in North America. The threshold percentage is 40 percent through 2023, increasing to 50 percent in 2024, 60 percent in 2025, 70 percent in 2026, and 80 percent after 2026.

To receive the $3,750 battery-components portion of the credit, the percentage of the battery's components manufactured or assembled in North America must also meet certain threshold amounts. For vehicles placed in service through 2023, the percentage is 50 percent. The percentage increases to 60 percent for 2024 and 2025, 70 percent for 2026, 80 percent for 2027, 90 percent for 2028, and 100 percent after 2028.

Certain higher-income taxpayers are not eligible for the credit. Specifically, no credit is allowed if the current year or preceding year's modified adjusted gross income (AGI) exceeds $300,000 for married taxpayers ($225,000 in the case of head of household filers; $150,000 in the case of other filers).

Credits are only allowed for vehicles that have a manufacturer's suggested retail price of no more than $80,000 for vans, SUVs, or pickup trucks, and $55,000 for other vehicles. Taxpayers are only allowed to claim the credit for one vehicle per year. Starting in 2024, taxpayers purchasing eligible vehicles can elect to transfer the tax credit to the dealer, so long as the dealer meets certain requirements. This provision does not apply to vehicles acquired after December 31, 2032.

Credit for Previously-Owned Clean Vehicles

The Act creates a new tax credit for buyers of previously owned qualified clean (plug-in electric and fuel cell) vehicles. The maximum credit is $4,000 and is limited to 30 percent of the vehicle purchase price. No credit is allowed for taxpayers above certain modified AGI thresholds. Married taxpayers filing a joint return cannot claim the credit if their modified AGI is above $150,000 ($112,500 in the case of head of household filers; $75,000 in the case of other filers). The taxpayer's modified AGI is the lesser of modified AGI in the tax year or prior year.

Credits are only allowed for vehicles with a sale price of $25,000 or less with a model year that is at least two years earlier than the calendar year in which the vehicle is sold. This credit can only be claimed for vehicles sold by a dealer and on the first transfer of a qualifying vehicle. Taxpayers can only claim this credit once every three years and must include the VIN on their tax return to claim a tax credit.

Starting in 2024, taxpayers purchasing eligible vehicles can elect to transfer the tax credit to the dealer, so long as the dealer meets certain registration, disclosure, and other requirements. The credit does not apply to vehicles acquired after December 31, 2032.

Extension, Increase, and Modifications of the Nonbusiness Energy Property Tax Credit (Renamed as the Energy Efficient Home Improvement Credit)

For years before 2022, a 10 percent tax credit, subject to a $500 per taxpayer lifetime limit, was available for qualified energy-efficiency improvements and expenditures for residential energy property on an individual's primary residence.

The Act extends the credit through 2032. In addition, beginning in 2023, the Act modifies and expands the credit, by:

- increasing the credit rate to 30 percent and increasing the annual per-taxpayer limit from $600 to $1,200, with a $600 per-item limit;

- for geothermal and air source heat pumps and biomass stoves, there is an annual credit limit of $2,000, and limits for expenditures on windows and doors are also increased, while biomass stoves are now eligible for tax credits;

- allowing a 30 percent credit, of up to $150, for home energy audits.

Restoration of 30 Percent Residential Energy Efficient Tax Credit (Renamed the Residential Clean Energy Credit)

A tax credit is currently provided for the purchase of solar electric property, solar water heating property, fuel cells, geothermal heat pump property, small wind energy property, and qualified biomass fuel property. Initially, the credit rate was 30 percent through 2019. It was then reduced to 26 percent through 2022, and was scheduled to be reduced to 22 percent in 2023 before expiring at the end of that year.

The Act extends the credit through December 31, 2034, restoring the 30 percent credit rate, beginning in 2023 through 2032, and then reducing the credit rate to 26 percent in 2033 and 22 percent in 2034. Qualified battery storage technology is also added to the list of eligible property.

Alternative Fuel Refueling Property Credit

Through 2021, taxpayers were allowed a tax credit for the cost of any qualified alternative fuel vehicle refueling property installed at a taxpayer's principal residence. The credit was equal to 30 percent of these costs, limited to $30,000 for businesses at each separate location with qualifying property, and $1,000 for residences. The Act extends this credit through December 31, 2032, and makes certain additional modifications.

Please let me know if you have questions or would like to meet to discuss the ramifications of the Act's various tax credit provisions or any of the Act's other provisions.

Extension of Health Insurance Subsidy

A health insurance subsidy is available through a premium assistance credit for eligible individuals and families who purchase health insurance through Exchanges offered under the Patient Protection and Affordable Care Act (PPACA). The premium assistance credit is refundable and payable in advance directly to the insurer on the Exchange. Individuals with incomes exceeding 400 percent of the poverty level ($54,360 for a one-person household in 2022) are normally not eligible for these subsidies. However, legislation passed in 2021 eliminated this limitation for 2021 and 2022 so that anyone can qualify for the subsidy. That legislation also limited the percentage of a person's income paid for health insurance under a PPACA plan to 8.5 percent of income. The Act extends these provisions through 2025.

Prescription Drug and Vaccine Cost Improvements

The Act - · eliminates beneficiary cost-sharing above the annual out-of-pocket spending threshold under the Medicare prescription drug benefit beginning in 2024;

· caps Medicare annual out-of-pocket spending for prescription drugs at $2,000 beginning in 2025 (with annual adjustments thereafter);

· establishes a program, beginning in 2025, under which drug manufacturers provide discounts to beneficiaries who have incurred costs above the annual deductible;

· eliminates cost-sharing under the Medicare prescription drug benefit for adult vaccines that are recommended by the Advisory Committee on Immunization Practices, and requires coverage, without cost-sharing, of such vaccines under Medicaid and the Children's Health Insurance Program (CHIP); and

· caps cost-sharing under the Medicare prescription drug benefit for a month's supply of covered insulin products at (1) for 2023 through 2025, $35; and (2) beginning in 2026, either $35, 25 percent of the government's negotiated price, or 25 percent of the plan's negotiated price, whichever is less.

If you would like to talk about how you might be able to take advantage of the Act's energy incentives or have questions about any of its provisions, please don't hesitate to call.

Sincerely,

Hansen Cochrane, Ltd.