The U.S. INFLATION REDUCTION ACT and Other U.S. Tax Developments

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Roadmap of Session

- Part 1: Background and Legislative History
- Part 2: Underlying Fiscal Policy and Projected Economic Effect
- Part 3: Key Outlays
- Part 4: Revenue Measures
- Part 5: Other Developments

Part 1: Background and Legislative History

Evolution of the Build Back Better Plan

- Proposed three legislative arenas
- Covid-19 relief spending was codified as the American Rescue Plan signed into law in March 2021
    - Expanded child credit, child care credit, earned income credit
    - Provided relief for industries especially hurt by Covid-19 like restaurants
    - Paid for Covid testing and vaccination
    - Cost: USD 1.9 trillion
    - Passed on strictly partisan lines
- Infrastructure repair and improvement: the Infrastructure Investment and Jobs Act was signed into law in November 2021. Measures include:
    - Enhancing clean water measures
    - Expanding high-speed internet access
    - Allocating funds for repair and improvement of roads and bridges
    - Funding improvements to public transit
    - Upgrading airports and ports
    - Expanding passenger rail

Part 1: Background and Legislative History

Evolution of the Build Back Better Plan (cont.)

- Infrastructure repair and improvement: the Infrastructure Investment and Jobs Act was signed into law in November 2021. Measures include:
  - Network of electric vehicle (EV) charging stations
  - Upgrade power infrastructure
  - Enhanced recovery and resiliency following natural disaster and cyberattack
  - Environment remediation
- The bill received some limited bi-partisan support (13 Republican members of the House). Progressive Democrats resisted, then criticized severing the infrastructure measures of BBB from the environmental, climate change and social measures that were severed and repackaged, originally as the ill-fated Build Back Better Act.
- Funding cost: USD 1.2 trillion

Part 1: Background and Legislative History

Evolution of the Build Back Better Plan (cont.)

- The environment, climate change and social aspects of the Build Back Better Plan were re-introduced as the Build Back Better Act (“BBBA”) which was the precursor to the Inflation Reduction Act of 2022 (“IRA”).
- The initial proposal was for expenditures of USD 3.5 trillion. That proposal was pared down to USD 2.2 trillion. The House of Representatives passed that bill on November 19, 2021 and sent it to the Senate.
- Since Republicans universally opposed the bill, the vote of every Democratic senator was needed. Joe Manchin (D-WV) and Kyrsten Sinema (D-AZ) voiced criticism of the bill as, among other things, inflationary and bloated. In December 2021, Manchin announced that he would not support the bill.
- After months of negotiations, horse trading and arm-twisting, mostly led by Senate majority leader Schumer (D-NY), the bill had been trimmed to USD 737 billion, renamed the Inflation Reduction Bill of 2022 and garnered the support of Senators Manchin and Sinema, thus ensuring passage in the Senate. The bill passed the House without difficulty and President Biden signed it into law on August 16, 2022.

Part 2:Underlying Fiscal Policy and Projected Economic Effect

- According to the White House, the IRA should reduce budget deficits by “hundreds of billions of dollars.” Another White House document indicates that the IRA should produce revenues in excess of expenditures of over USD 300 billion. That is touted as likely to reduce inflation at the margin. I haven’t found one independent source that expects the effect on inflation to be significant.
- To put these numbers into perspective, the “hundreds of billions” of reduced deficit is scored over a ten-year period. On the other hand, annual budget deficits appear to be chronically well over USD 1 trillion annually these days .
- Various think tanks, depending on their political leanings, offer estimates that range from net job growth of over 1 million new jobs to actual net job loss, based on an estimated economic contraction. One might also reasonably ask what the effect on inflation would be of producing a substantial number of new job openings during a period of labor shortages, largely fueled by a tsunami of retiring baby-boomers.

Part 3: Key Outlays (aka “Investments”)

Energy Security and Climate Change

- USD 369 billion according to the Joint Committee on Taxation
- Electric Vehicles (“EV”) Incentives
  - Eligibility requires modified adjusted gross income of no more than USD 150,000 (single) or 300,000 (married) for new EVs. For used EVs, these income caps drop to USD 75,000 (single) and 150,000 (married)
  - Not for “luxury vehicles” costing USD 55,000 or more for sedans or USD 80,000 for SUVs or trucks
  - Tax credit of USD 7,500 for new EVs and USD 4,000 for used EVs
- Renewable energy and grid energy storage
  - 950 million solar panels
  - 120,000 wind turbines
  - 2,300 grid-scale battery plants
  - Reduce greenhouse gases by 1 gigaton or a billion metric tons by 2030

Part 3: Key Expenditures (aka "Investments")

Health Care Measures

- Cutting the Cost of Prescription Drugs
  - Medicare given mandate to negotiate lower prices for certain common drugs (also scored as deficit reduction)
    - Expected to lower costs for both the government and Medicare participants
    - Cost of insulin capped at USD 35 per month
    - Part D out-of-pocket drug cost capped at USD 2,000 per year by 2025
- Extend subsidy of USD 800 per year on premiums under the Affordable Care Act marketplace
  - Government estimates that 13 million Americans will benefit
  - Government estimates that a new low of 8 percent of Americans with no health insurance will remain

Part 3: Key Expenditures (aka “Investments”)

Internal Revenue Service Expansion

- Increase IRS budget by USD 80 billion over the next 10 years
- Intended to address the so-called “tax gap” or underpayment of taxes and supposedly collect over USD 120 billion of unpaid taxes
  - A number of times in the past, the IRS has sought and received additional funding from Congress with the promise of increasing revenues substantially. The promises of dramatically increased revenues have not come to fruition.
  - Treasury Secretary Yellin has instructed the IRS not to target taxpayers with income below USD 400,000 and to focus instead exclusively on “high-end noncompliance”
  - The IRS has been operating very poorly since the Covid-19 pandemic, reaching all-time lows in its service
  - Is additional money enough to fix what’s broken or do the problems run much deeper than that?
- Key mandates include:
  - Development of IRS-run tax return preparation and e-filing software—LOL
  - Improved taxpayer services (such as answering the phone!)
  - Enforcement (because every taxpayer is a tax cheat until proven otherwise)
  - Operations support (basically the back-office property, plant and equipment)

Part 4: Revenue Measures

Corporate Alternative Minimum Tax ("CAMT")

- Applicable to tax years beginning after December 31, 2022
- This is the U.S. approach to the Pillar 2 minimum tax of the OECD Base Erosion and Profit Shifting initiative
  - As of November 2021, 137 tax jurisdictions committed to implementation of the Pillar 2 minimum tax
- Applies to corporate groups that have over USD 1 billion in net profit
  - More precisely, tax applies to "applicable corporations". These are corporations with satisfy the "average annual adjusted financial statement income test"
  - Exception for S corporations, registered investment companies and real estate investment trusts.
  - Exception in the case of a change of ownership
  - The test is met if the average annual adjusted financial statement income exceeds USD 1 billion for a three-year period.
  - If the corporation has existed for less than three years, then only those years are tested. Any short taxable years require annualization.
  - The applicable corporation includes "component members" This generally means, for this purpose, share ownership of over 50 percent between group members.
  - For so-called "foreign-parented multinational groups," the adjusted financial statement income ("AFSI") of the entire multinational group is tested for the average AFSI of USD 1 billion. In addition, if the U.S. member corporation or corporations have AFSI that exceeds USD 100 million

Part 4: Revenue Measures

Corporate Alternative Minimum Tax (“CAMT”) (cont.)

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- How the CAMT is calculated
  - The applicable corporation is liable for the CAMT to the extent that the “tentative minimum tax” exceeds regular U.S. corporate tax plus base erosion anti-abuse tax (BEAT)
  - Tentative minimum tax is equal to 15 percent of AFSI less the CAMT foreign tax credit

Part 4: Revenue Measures

Corporate Alternative Minimum Tax ("CAMT") (cont.)

- Adjusted financial statement income (AFSI) defined in new section 56A
  - Adjustments to be determined by the IRS when the taxable year and financial statement period are different
  - If a component corporation is not a consolidated affiliate, dividends only included when paid, i.e., no investment accounting, except for the controlled foreign affiliate rules, when accruals do occur
  - Include a corporate partner's distributive share of partnership income
  - For a foreign corporation, income effectively connected with the conduct of a U.S. trade or business is taken into account
  - If the applicable corporation owns a disregarded entity, the AFSI of the disregarded entity is included
  - The IRS is to issue regulations to prescribed appropriate adjustments for creditable foreign income taxes
  - AFSI is to be reduced for tax depreciation and increased by book depreciation
  - AFSI is reduced for tax amortization of intangibles only in the case of "qualified wireless spectrum" used in the trade or business of a wireless telecommunications carrier
  - Book accrued pension expense is reversed and any tax income inclusion or deduction for pension expense is taken into account for AFSI

Part 4: Revenue Measures

Corporate Alternative Minimum Tax ("CAMT") (cont.)

- Issues for state income tax
  - Any state minimum tax, whether based on the federal or not?
  - Automatic "rolling" conformity of state tax law to the federal?
  - "Fixed" conformity as of a specific date?
- Sure to be numerous general and industry-specific issues. One is what to do about tax-deferred reorganizations that affect AFSI

Part 4: Revenue Measures

Stock Buyback Excise Tax

- Applies to public corporations that repurchase or redeem their own shares
- The buyback tax is equal to 1 percent of the fair market value of repurchased shares

Part 5: Other Developments

- The CHIPS Act (i.e., Creating Helpful Incentives to Produce Semiconductors and Science Act of 2022) was signed into law on August 9. It was designed to promote U.S. competitiveness, innovation and national security by providing funding of USD 280 billion to boost domestic research and manufacturing of semiconductors in the U.S.
  - Compare this with Chinese Chairman Xi Jinping's speech to the Communist Party Congress vowing to continue massive R&D funding in order to achieve Chinese technological independence and superiority

- Proposed Regulation Sec. 20.2010-1(c): exception to a special coordinating rule for possible future reduction of the basic exclusion amount after 2025

- The Supreme Court issued a writ of certiorari for the case of *Bittner v. United States* in order to address the split between the Fifth and Nineth Circuits on the issue of whether the civil penalty for non-willful FBAR non-compliance. The penalty is $10,000 for non-willful FBAR violations should be based on each account or only once per year for the FBAR disclosure form, FinCen 114.

- Revenue Procedure 2022-32 providing a simplified method for obtaining an extension of time to make a "portability" election for unused basic exclusion amount.

- In July the Treasury Department abrogated the U.S.-Hungary Tax Treaty effective for 2024 because of Hungary's opposition to the OECD BEPS initiatives within the European Union. A number of EU members criticized the measure as improper meddling in EU affairs.

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