Butterfield + Co.
CPAs, Inc.

August 29, 2022

To our Clients and Friends,

The Inflation Reduction Act of 2022 (the Act) was signed into law by President Biden on August 16, 2022. We wanted to take this opportunity to highlight some of the tax provisions addressed in the Act that may affect your tax situation.

Individuals

The following is a summary of the Act's key provisions that may affect your individual tax situation.

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% through 2023, increasing to 50% in 2024, 60% in 2025, 70% in 2026, and 80% 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%. The percentage increases to 60% for 2024 and 2025, 70% for 2026, 80% for 2027, 90% for 2028, and 100% 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% 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 2 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 3 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% 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% and increasing the annual per-taxpayer limit from $600 to $1,200, with a $600 per-item limit;
- increasing the limits for expenditures on windows and doors and adding biomass stoves to the list of property eligible for tax credits - the annual credit limit for geothermal and air source heat pumps and biomass stoves is now $2,000;
- allowing a 30% credit of up to $150, for home energy audits.

Restoration of 30% 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% through 2019. It was then reduced to 26% through 2022 and was scheduled to be reduced to 22% in 2023 before expiring at the end of that year.

The Act extends the credit through December 31, 2034, restoring the 30% credit rate, beginning in 2023 through 2032, and then reducing the credit rate to 26% in 2033 and 22% 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% 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.

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% 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% 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% of the government's negotiated price, or 25% of the plan's negotiated price, whichever is less.

Businesses

The following is a summary of the Act's key provisions that may affect your business tax situation.

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% 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%, 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% 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%.

Clean Vehicle Credit

The Act provides a credit for businesses for new clean vehicles placed into service during the tax year with the credit and qualifications similar to those found in the "Individuals" section of this letter.

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% 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% and a bonus credit level of 30% 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% of qualified investments in qualified advanced energy projects. To receive a bonus rate of 30%, taxpayers must satisfy the prevailing wage requirements for the establishment, expansion, or re-equipping of a manufacturing facility and for 5 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%.

Credit for Electricity Produced from Certain Renewable Resources

The Act extends the production tax credit (PTC) for 5 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% base credit rate or a 30% 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 qualified 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%, 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 don't hesitate to call us with questions or for additional strategies. We'd be happy to assist you in any way that we can.

Very truly yours,

Butterfield + Co. CPAs, Inc.

Butterfield + Co. CPAS, Inc.