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Tax Implications of the Inflation Reduction Act of 2022

Instead of the individual tax increases we all expected, the Inflation Reduction Act of 2022 contains various provisions aimed at reducing healthcare costs and promoting clean energy.

Wealth Planning Department
Baird Private Wealth Management

August 2022

Most tax law discussions over the last year have focused on increasing income and estate taxes on the wealthy. However, given the tight margins in Congress, those provisions were always going to be difficult to pass. Instead, the Inflation Reduction Act of 2022, recently signed by President Biden, focused primarily on clean energy incentives as well as reduced healthcare costs for Americans. While the bill did include the previously proposed corporate minimum tax, the much-discussed income and estate tax hikes were left out.

CLEAN ENERGY INCENTIVES

With the goal of a 40% emissions reduction by 2030, the Inflation Reduction Act expanded and extended a number of clean energy incentives already in place for both individuals and businesses. Homeowners that make qualified energy-efficient improvements (such as new windows, doors, roofs, insulation, etc.) or install energy-efficient appliances (heating and air systems, water heaters, etc.) may be eligible for an increased tax credit. The credit, previously known as the Residential Energy Property Credit or the Nonbusiness Energy Property Credit, has been renamed the "Energy Efficient Home Improvement Credit". The maximum credit amount varies based on the type of improvement. The existing home energy credit was scheduled to expire after 2021, but has now been extended through 2022, while the enhanced credit applies to improvements installed in 2023 through the end of 2032. Homeowners considering these improvements may want to wait until 2023 for the installation in order to qualify for the new larger credit.

Additionally, those who install certain qualifying property (solar electric property and water heaters, geothermal heat pumps, battery storage technology, etc.) are allowed a tax credit equal to 22% to 30% of the cost. This was previously called the Residential Energy Efficient Property Credit and was available through 2023, but has been renamed the "Residential Clean Energy Credit" and has been extended through 2034.

The bill modified and extended the availability of the Qualified Plug-in Electric Drive Motor Vehicle Credit (renamed the "Clean Vehicle Credit"). A maximum credit of $7,500 still applies to newly purchased qualified electric or hydrogen fuel cell vehicles, and there is a new credit for purchasing previously owned electric and hybrid plug-in vehicles. This new credit equals 30% of the cost of the car, with a maximum credit of $4,000, and the car must be at least 2 years old with a purchase price of no more than $25,000. This credit applies to purchases in 2023, so prospective buyers may want to delay a purchase until next year in order to qualify. Both credits are available through 2032 and are subject to a phaseout once income exceeds certain levels.

HEALTH CARE

Several provisions in the bill are aimed at reducing healthcare costs. The expanded Affordable Care Act (ACA) provisions included in the pandemic-relief bills in 2021 have been extended through 2025. These provisions essentially removed the income limit for taxpayers to qualify for the subsidy and shrank the percentage of income that the enrollee was expected to contribute towards their health insurance premium through marketplace coverage.

The bill also incorporates price control on drugs sold through Medicare. Starting in 2023, Medicare beneficiaries will see price caps on certain out-of-pocket drug costs and co-pays. Additionally, manufacturers will now be required to negotiate price caps with the federal government on Medicare offered prescription drug and insulin products. These negotiated prices will begin to take effect in 2026.

IRS FUNDING

Outlined in the Inflation Reduction Act is the appropriation of almost $80 billion toward IRS resources over the next 10 years. More than half of this, almost $45.6 billion, will be spent on enhancing enforcement activities including tax assessment and collection, legal support, criminal investigations, and digital asset monitoring. The IRS plans to focus on areas of noncompliance with large corporations and flow-through businesses, high-net worth individuals, and multinational taxpayers with international tax exposure. This funding comes on the heels of a sharp decline in audits in recent years due to staff reductions and the increasing complexity of the tax code. Taxpayers can expect to see an increase in tax audits beginning in a few years, making proper record keeping increasingly important.

EXCESS BUSINESS LOSS

The Tax Cuts and Jobs Act included a provision under section 461(l) which prevents noncorporate taxpayers (such as sole proprietors and owners of pass-through entities) from deducting net business losses in excess of a threshold ($500,000 for married taxpayers filing jointly, $250,000 for all others, adjusted for inflation). In other words, an individual’s total business expenses cannot exceed their gross business income (or gain) by more than that threshold amount. The net loss over the threshold is carried forward to the following tax year and treated as a net operating loss (NOL) under section 172. The CARES Act retroactively suspended these rules for tax years 2018 through 2020, making the limitation apply to tax years 2021 through 2026. The Inflation Reduction Act extended these rules by 2 years, through 2028.

PROVISIONS NOT INCLUDED

As previously stated, many of the tax law changes frequently discussed did not ultimately make it into the Inflation Reduction Act. Specifically, the following items were not included in the final bill:

- Increase in ordinary and capital gain tax rates
- High-income surcharge
- Extension of the enhanced child tax credit
- Extension and/or change to $10,000 state and local tax (SALT) deduction limit
- Medicare surtax expansion
- Elimination of the backdoor Roth strategy
- Deferral limitations on 1031 exchanges
- Tightening of the carried interest rules
- Creation of a new Wealth Tax
- Any changes to the estate tax system, including lowering the tax exemption, increasing the tax rate or limits on the use of certain trusts
- The basis adjustment at death rules
- Increase in corporate tax rate

Although these provisions were not included in the recent bill, they could still reappear in the future. It’s unlikely we’ll see much activity over the next few months as we approach mid-term elections, however, individuals should look for these topics to reemerge during Congress’ lame duck session towards the end of the year.