August 7, 2022

Skadden

Senate Passes Landmark Bill With Climate, Tax, Energy and Health Care Implications

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

One Manhattan West
New York, NY 10001
212.735.3000

Editor's note:* *President Joe Biden signed the Inflation Reduction Act into law on August 16, 2022, following House passage on August 12, 2022.

On August 7, 2022, the Senate passed the Inflation Reduction Act (the Act), which is expected to have a significant impact on climate, tax and health care policy in the United States. The result of intense negotiations among Democrats including Sen. Joe Manchin, D-W.Va., and Senate Majority Leader Chuck Schumer, D-N.Y., the Act sets a goal of reducing carbon emissions in the U.S. by 40% by 2030 and includes parts of the Build Back Better Act (BBBA).

In this alert, we provide an outline of the Act's major provisions, which are designed to spur clean energy, implement a 15% minimum tax on corporations and lower prescription drug prices. To achieve its aim, the Act contains an array of grants, loans and tax credits for consumers and businesses — provisions that would affect industries ranging from automaking to utilities and energy. A provision to modify the treatment of carried interests was removed during negotiations with Sen. Kyrsten Sinema, D-Ariz., a moderate and key vote, and was replaced by a 1% excise tax on stock buybacks by U.S. public corporations.

Senate Democrats, who passed the measure through the budget reconciliation process, have said provisions in the Act will raise enough in revenue to balance out the new investments and reduce deficits over the next decade. The House of Representatives is expected to pass the Act on August 12, 2022.

The key provisions outlined in this alert are:

- **Corporate tax.** The Act sets a 15% corporate minimum tax rate on companies with profits of more than $1 billion and includes new and expanded energy-related tax credits. It also imposes a 1% excise tax on stock repurchases by publicly traded companies. Additionally, the Act budgets for additional Internal Revenue Service (IRS) enforcement resources, with the goal of bringing in $124 billion in tax revenue currently lost to fraudulent tax returns (after subtracting enforcement costs).
- **Energy transition/greenhouse gas emissions reduction.** The bill includes significant investments in clean energy. They include tax credits and other incentives for investments in renewable and other innovative energy technologies that avoid or reduce greenhouse gases, for consumers to make their homes more energy efficient and for the purchase of vehicles with lower emissions.
- **Domestic manufacturing.** The bill also includes incentives to establish more manufacturing, mining and processing facilities in the United States that produce clean energy inputs, components and finished products.

- **Health care.** The Act allows Medicare to negotiate certain prescription drug and biologics prices, caps the amount individuals must pay out of pocket for Medicare prescription drugs and continues Affordable Care Act (ACA) premium subsidies for another three years.

Vice President Kamala Harris provided the tie-breaking vote to pass the bill following a marathon overnight session during which Republicans introduced a flurry of amendment votes. Given the complexity and magnitude of the proposed measures, please consult your Skadden contact for more information.

Corporate Tax

The Act establishes various tax measures to raise hundreds of billions of dollars in revenue for the climate and clean energy initiatives (including new and expanded energy-related tax credits, discussed further below). It sets a 15% corporate minimum tax rate for companies whose profits exceed $1 billion, among other measures. A proposal to broaden the scope of the carried interest rule was dropped during negotiations with Sen. Sinema. Added into the revised bill is a 1% excise tax on stock repurchases by U.S. publicly traded corporations that was first proposed in the BBBA.

The Act is notable for what it does not include: increased tax rates on individuals and corporations or a repeal of the limitations on state and local tax deductions.

Corporate Alternative Minimum Tax

The corporate alternative minimum tax (Corporate AMT) would apply to large corporations — generally those with financial statement income exceeding $1 billion, measured using a three-year average. At a high level, the AMT is designed to ensure that large corporations pay a minimum tax of 15% on their financial statement — or "book" — income. The current corporate tax rate is 21%, but some companies have had effective tax rates below 15% in certain years.

Key Points

- The new Corporate AMT would affect large corporations that are able to reduce their "cash tax" liability as a result of certain attributes or "book-tax" differences.
- A late-breaking amendment to the bill revised the application of the $1 billion income threshold to ensure that the provision does not apply to unrelated companies that are otherwise below the threshold but that are under common ownership of an investment fund, where the aggregation of their earning might have put them above the threshold. Such amendment was paid for by extending the excess business loss limitation provisions by two years.
- Corporations with large tax deductions that are not matched by book income deductions — for example, stock-based compensation — may face increased tax liabilities under the Act.
- The first draft of the bill did not include any special rules for accelerated depreciation, but the final bill reduces financial statement income in respect of accelerated depreciation (with corresponding increases in subsequent years), making it less likely that the new minimum tax will apply to many manufacturers with large capital expenditures.
- For some taxpayers, the proposed change would simply accelerate such additional taxes, since payments under the AMT can be used as a credit in future years when the regular tax liability exceeds the AMT. For others, the tax may represent a permanent additional tax, where tax deductions exceed book deductions on a permanent basis, for example in respect of stock-based compensation.
- Because the AMT is effective for tax years beginning after December 31, 2022, taxpayers should consider book tax differences that straddle that effective date and thus are treated similarly to permanent differences. For example, deductions taken into account for the 2022 taxable year will reduce tax in 2022 but later decrease the adjusted financial statement income (AFSI) if the corresponding book deduction is taken into account in a post-effective-date year.
- Finally, taxpayers with significant net operating losses from pre-2020 years may face a permanent additional tax liability under the new Corporate AMT, as such losses are not permitted to be carried forward.

How the Corporate AMT Is Calculated

The Corporate AMT is based on a corporation's AFSI, which equals a corporation's income as reported on its applicable financial statements — generally its audited financial statements used for Securities and Exchange Commission (SEC) reporting or other nontax purposes. Special rules apply for calculating AFSI earned by consolidated groups, corporations that own interests in other nonconsolidated corporations (including foreign corporations) and corporations that own interests in partnerships. In addition, AFSI generally includes a domestic corporation's pro rata share of the financial statement income of its foreign subsidiaries that are controlled foreign corporations (CFCs) as well as the income of "disregarded entities" owned by a corporation.

AFSI is reduced by financial statement losses carried over into a taxable year, subject to a limitation equal to 80% of financial statement income (similar to the net operating loss limitation for "regular" tax purposes), and, importantly, only in respect of losses for taxable years ending after December 31, 2019.

The Corporate AMT is then reduced by the AMT foreign tax credit, which is generally based on the foreign tax credits included on the financial statement income of a domestic corporation, plus a pro rata share of the foreign taxes reported on the financial statements of foreign subsidiaries of a domestic corporation, with a "haircut" to reduce those taxes to the 15% rate imposed by the Corporate AMT.

Finally, the Corporate AMT can be reduced by general business credits, which are largely limited to 75% of a corporation's tax liability, but are not limited by the "tentative minimum tax" imposed by the AMT. Thus, corporate taxpayers may still be able to reduce their final tax liability below the 15% rate as a result of the availability of general business credits.

Stock Repurchase Excise Tax

The Act revives a provision previously included in the BBBA that imposes an excise tax on certain "repurchases" of stock by publicly traded U.S. corporations and certain of their affiliates, disadvantaging U.S.-parented public corporations vis-a-vis their foreign competitors. The provision included in the Act is substantively identical to the repurchase excise tax provision previously included in the BBBA. Under the Act, the excise tax would apply to repurchases occurring after December 31, 2022, irrespective of when the repurchase program was authorized.

The provision imposes a 1% excise tax on publicly traded U.S. corporations (and certain U.S. subsidiaries of publicly traded non-U.S. corporations) for the value of any stock that is repurchased during the taxable year by the corporation or "specified affiliates" in which the corporation owns a 50% or greater equity interest. A "repurchase" includes a "redemption" as defined under the U.S. tax code (generally, any acquisition of stock by the corporation in exchange for cash or property other than the corporation's own stock or stock rights) and any other "economically similar" transaction, as determined by the secretary of the Treasury.

For further discussion, including potential consequences and open questions, please see our previous analysis of the BBBA version of the provision.

Energy-Related Tax Credits

The bill extends and expands key energy tax credit provisions that have supported the growth of the renewable energy sector and promote carbon capture, and introduces new tax credits intended to promote clean hydrogen and other efforts to mitigate greenhouse gas emissions.

New tax credits. New clean energy production credits (Section 45Y) and clean energy investment credits (Section 48D) would be created that would apply, on a technology-neutral basis (*e.g.*, without regard to energy source), to certain electricity facilities placed in service after 2024. The Section 48D credit would also apply to certain energy storage technology. Both credits would phase out for new facilities that begin construction after 2032 or after certain national emissions reduction goals are achieved, whichever is later. The Act would also create new credits for nuclear power production, clean vehicles, clean hydrogen, advanced manufacturing production and clean fuel production, as well as extend and/or expand several other existing energy-related credits.

Expanded energy production and energy tax credits. Section 45 renewable energy production credits (PTC) and the Section 48 energy credits (ITC) would generally be extended to eligible property or facilities beginning construction before 2025. The Act would also repeal the current phaseouts of these tax credits for property placed in service after 2021. Additionally, several new categories of property would be eligible for the ITC if placed in service after 2022, including certain energy storage technology, biogas projects, microgrid controller equipment, fuel cells using electromechanical processes and dynamic glass equipment. The Act would significantly reduce PTC and ITC amounts for projects that fail to meet new wage and apprenticeship requirements and that begin construction 60 or more days after the publication of Treasury guidance on such requirements.

Increased credit amounts. Projects that meet certain domestic content standards (*e.g.*, 100% of the iron and steel and an increasing percentage of the components are produced in the United States) or are located in certain "energy communities" (which include areas with employment or local tax revenues above specified thresholds related to fossil fuels and higher-than-average unemployment rates) and that otherwise qualify for the PTC, ITC, Section 45Y or Section 48D credit would be eligible for increased credit amounts. The Act would also direct the Department of the Treasury to ensure certain projects located in low-income communities receive an increased ITC.

Carbon capture and sequestration credits. The Act would expand eligibility for carbon capture and sequestration credits under Section 45Q by (i) extending the beginning of construction deadline for projects to 2032 (from 2025), and (ii) significantly lowering the amount of carbon that projects must capture annually. The Act would also materially increase the dollar amount of such credits (particularly for direct air capture), provided a project satisfies certain wage and apprenticeship requirements or begins construction prior to the date that is 60 days after the

Department of the Treasury publishes guidance on such requirements. Additionally, the Act would make Section 45Q credits attributable to equipment placed in service after 2022 eligible for "direct pay" for the year the equipment is placed in service and the following four years, regardless of whether the entity claiming credits is a tax-exempt entity.

Tax credit transferability, direct pay, carryback. Under the bill, several energy-related credits would be (i) transferable to unrelated parties for cash, subject to certain requirements, (ii) eligible for "direct pay" if claimed by certain tax-exempt governmental and cooperative entities, and (iii) eligible to be carried back for up to three years.

Paul Schockett, Sean Shimamoto, Moshe Spinowitz, Martin de Jong, Leo Greenberg, Scott Greenberg and Joshua G. Rabon

Transition to Clean Energy

The bill was introduced as the most significant investment in climate change in U.S. history, and it has an ambitious aim: to cut carbon emissions by 40% by 2030. The Act includes sizable investments in clean energy and to reduce greenhouse gas emissions, as well as to support the domestic production of advanced technology vehicles and the transition to zero-emissions vehicles.

Innovative Clean Energy Loan Guarantees

The Act appropriates $40 billion for loan guarantees to eligible U.S. projects employing new or improved technology under Section 1703 of the Energy Policy Act of 2005. In addition, $3 billion is set aside to cover the credit subsidy cost of such loan guarantees. The bill also amends the statute governing the Title XVII loan guarantee program to permit the Department of Energy (DOE) to guarantee loans originated by commercial banks and other nonfederal lenders to Section 1703-eligible projects.

Energy Infrastructure Reinvestment Financing

The Act amends the Energy Policy Act to establish a new DOE loan guarantee program for projects to (i) retool, repower, repurpose or replace energy infrastructure that has ceased operations or (ii) enable operating energy infrastructure to avoid, reduce, utilize, or sequester air pollutants or anthropogenic emissions of greenhouse gases. The Act appropriates $5 billion for activities under the new program and authorizes loan guarantees covering a total principal amount of up to $250 billion.

Offshore Wind

In addition to general support for renewable energy, the Act promotes the development of offshore wind. It lifts the Trump-era moratorium on offshore wind leases on the outer continental shelf of Southeastern coastal states, and it provides funding to coordinate and facilitate action by regulatory authorities involved in offshore wind siting and permitting activities. The Act also extends the reach of the Outer Continental Shelf Lands Act (OCSLA) to overseas territories (Puerto Rico, Guam, American Samoa, U.S. Virgin Islands and Northern Mariana Islands) to permit exploration of offshore wind opportunities.

Electric Transmission

The Act appropriates funds to provide financing and technical support to accelerate construction of new electric transmission projects, including a $2 billion appropriation for direct loans to nonfederal borrowers for the construction or modification of electric transmission facilities that are designated as necessary in the national interest (available through September 30, 2030). Grants may also be made available for economic development activities for communities affected by the project.

Oil and Gas

Numerous provisions of the Act would affect the oil and gas industry. Of note are increases to oil and gas royalty and rental rates, and to the minimum required bid in onshore lease auctions. The Act also requires four lease sales (by December 31, 2022) that were previously included in the 2017-22 Outer Continental Shelf Oil and Gas Leasing Program, and it implements timing and annual acreage minimums for onshore and offshore oil and gas lease sales as prerequisites for federal renewable leasing and right-of-way issuances.

Amendments to the Clean Air Act creating both subsidies and penalties would impact the oil and gas industry. The Methane Emissions Reduction Program establishes a methane emissions and waste reduction incentive program for petroleum and natural gas systems:

- $850 million of funding for methane mitigation and monitoring, and for permanently shutting in and plugging wells on nonfederal land (available until September 30, 2028), and
- $700 million for methane mitigation at marginal conventional wells (available until September 30, 2028).

The amendments also establish a penalty for excess methane emissions from a wide range of equipment and facilities used in petroleum, natural gas and liquefied natural gas production, processing, transmission and storage. The Act establishes safe harbor exemptions from the penalties, including for regulatory delays and through compliance with state laws that provide for similar emissions reductions.

Lance T. Brasher and Joshua B. Nickerson

Investments in Greenhouse Gas Emissions Reductions

Advanced Industrial Technology at Nonpower Industrial or Manufacturing Facilities

The Act authorizes the DOE to provide more than $5.8 billion in grants, rebates, direct loans and cooperative agreements on a competitive basis for up to 50% of project costs to install advanced industrial technology designed to accelerate the reduction of greenhouse gas emissions to net zero (available through September 30, 2026). The funding applies for domestic, nonfederal, nonpower industrial or manufacturing facilities engaged in energy-intensive industrial processes, including in production processes for iron, steel, steel mill products, aluminum, cement, concrete, glass, pulp, paper, industrial ceramics and chemicals.

Consumer Investments in Clean Technology

The bill provides incentives to help consumers buy energy-efficient and electric appliances, clean vehicles and solar panels for homes. Specifically, the bill includes:

- $9 billion in consumer home energy rebate programs,
- 10 years of consumer tax credits to make homes more energy efficient,
- tax credits to buy electric vehicles, and
- a $1 billion grant program to make affordable housing more energy efficient.

Environmental Justice

The bill includes over $60 billion in environmental justice initiatives to help disadvantaged communities, including:

- $3 billion in Neighborhood Access and Equity Grants to support equitable transportation planning and community engagement activities,
- $3 billion in block grants to address environmental health problems,
- $3 billion in grants for improving air quality near ports, and
- $1 billion for clean heavy-duty vehicles like buses and garbage trucks.

Greenhouse Gas Reduction Fund

The bill amends the Clean Air Act to establish the Greenhouse Gas Reduction Fund with approximately $27 billion in funding for direct and indirect financial and technical assistance to deploy projects and technologies, including residential rooftop solutions, to reduce or avoid greenhouse gas emissions (available until September 30, 2024).

Agriculture

The bill includes funding to implement climate-friendly agriculture practices, grants to support forests and coastal habitats, and tax credits and grants for biofuels and biofuel infrastructure. It appears that this money will fund programs that provide financial and technical assistance to farmers and rangers to engage in smart agricultural practices, such as sequestering carbon, using cover crops, reducing water contamination, and protecting pollinators and native plants.

Domestic Automotive Manufacturing

The bill includes significant funding to support domestic advanced technology automotive manufacturing and procurement of zero-emissions vehicles:

- $3 billion to the DOE for the credit subsidy cost associated with direct loans for reequipping, expanding or establishing a manufacturing facility in the U.S. to produce — or for engineering integration performed in the U.S. of — advanced technology vehicles that emit low or zero greenhouse gases.
- $2 billion to provide grants of up to 50% of the cost for projects enabling the domestic production of efficient hybrid, plug-in electric hybrid, plug-in electric drive and hydrogen fuel cell electric vehicles (available through September 2031).
- $1 billion to fund the replacement of nonzero emissions vehicles with zero-emissions vehicles and related infrastructure (available until September 30, 2031).

Lance T. Brasher, Elizabeth A. Malone and Joshua B. Nickerson

Health Care

To help offset the costs of new subsidies, tax credits and other incentives, the Act includes several measures to reduce government and individual health care costs. The Act achieves these savings by imposing controls on Medicare drug and biologic spending and by continuing the provision of premium subsidies for individuals purchasing insurance made possible by the ACA.

Senate Passes Landmark Bill With Climate, Tax, Energy and Health Care Implications

Prescription drug pricing. The Act requires Medicare, for the first time, to negotiate prices for certain prescription drugs (Part D) and biologics (Part B). Medicare will negotiate the price of 10 Part D drugs in 2026, 15 Part D drugs in 2027, 15 Parts B and D drugs in 2028, and 20 Part B and D drugs in 2029. The products subject to negotiation include certain Part D drugs that received Food and Drug Administration (FDA) approval at least seven years prior (small molecule drugs) and Part B biologics that received FDA approval at least 11 years prior, and which are not subject to generic or biosimilar competition.

The Act also requires drug companies to pay rebates to Medicare if prices paid by Medicare increase at a rate that is faster than inflation. This represents a significant change from earlier versions of the proposed legislation, which had also required drug companies to pay rebates to Medicare if prices increased faster than inflation in the commercial market.

Medicare out-of-pocket costs. The Act also includes several provisions that protect against out-of-pocket costs for Medicare patients. In particular, the Act:

- caps Medicare prescription drug out-of-pocket spending at $2,000 in 2025,
- eliminates the 5% co-insurance that Medicare prescription drug enrollees must pay after their drug costs qualify for catastrophic coverage, starting in 2024,
- limits Medicare prescription drug premium increases to no more than 6% annually through at least 2029, and
- adds new cost-sharing provisions for insulin products in 2023.

Additionally, the Act delays implementation of the Trump-era rebate rule, which would have excluded certain manufacturer rebates paid to Medicare drug coverage plans from anti-kickback safe harbor protection, until 2032.

The Act imposes an excise tax and significant penalties for noncompliance, meaning that companies will not only have to maintain strong price reporting controls but also will have to contend with even greater overall scrutiny of drug prices.

Affordable Care Act subsidies. The Act extends through 2025 the expanded subsidies provided in the 2021 American Rescue Plan Act, which enables ACA participants to pay no more than 8.5% of their income toward health insurance premiums. Without the subsidies, ACA health care premiums are expected to rise, potentially causing many to drop their coverage or utilize fewer health care services.

Jennifer L. Bragg, Avia M. Dunn, Maya P. Florence, Bill McConagha and Neepa K. Mehta

Senate Passes Landmark Bill With Climate, Tax, Energy and Health Care Implications

Contacts

Tax

Victor Hollender
Partner / New York
212.735.2825
victor.hollender@skadden.com

Paul Schockett
Partner / Washington D.C.
202.371.7815
paul.schockett@skadden.com

Sean Shimamoto
Partner / Palo Alto
650.470.4670
sean.shimamoto@skadden.com

Moshe Spinowitz
Partner / Boston
617.573.4837
moshe.spinowitz@skadden.com

Martin de Jong
Associate / Palo Alto
650.470.3151
martin.dejong@skadden.com

Leo Greenberg
Associate / Boston
617.573.4853
leonard.greenberg@skadden.com

Scott Greenberg
Associate / Washington, D.C.
202.371.7041
scott.greenberg@skadden.com

Joshua G. Rabon
Associate / Washington, D.C.
202.371.7157
joshua.rabon@skadden.com

Energy and Infrastructure Projects

Lance T. Brasher
Partner / Washington, D.C.
202.371.7402
lance.brasher@skadden.com

Joshua B. Nickerson
Counsel / Washington, D.C.
202.371.7268
joshua.nickerson@skadden.com

Environmental

Elizabeth A. Malone
Counsel / Washington, D.C.
202.371.7239
elizabeth.malone@skadden.com

Life Sciences and Health Care

Jennifer L. Bragg
Partner / Washington, D.C.
202.371.7980
jennifer.bragg@skadden.com

Avia M. Dunn
Partner / Washington, D.C.
202.371.7174
avia.dunn@skadden.com

Maya P. Florence
Partner / Boston
617.573.4805
maya.florence@skadden.com

William (Bill) McConagha
Partner / Washington, D.C.
202.371.7350
william.mcconagha@skadden.com

Neepa K. Mehta
Associate / Washington, D.C.
202.371.7676
neepa.mehta@skadden.com