TAX ALERT

11/29/2022

Multiple New Tax Incentives in the CHIPS and Inflation Reduction Acts

The Creating Helpful Incentives to Produce Semiconductors for America Act (CHIPS Act) provides generous federal tax incentives to increase domestic production of semiconductors, while the Inflation Reduction Act (IRA) includes significant provisions related to climate change, providing federal energy related tax credits.

Overview of the 2022 CHIPS Act

The CHIPS Act combines both grants and a new tax credit to fully make up for this cost differential, thereby incentivizing the "re-shoring" of semiconductor production. While the incentives themselves are narrowly targeted, the expansion of semiconductor production should benefit a wide range of industries.

In particular, re-shoring could reduce the risks of future supply chain issues for the many goods and devices that rely on semiconductor chips, from cell phones and vehicles to children's toys. The law also intends to address national security concerns related to the reliance on foreign production of semiconductors.

New CHIPS Act Tax Credits

The CHIPS Act creates a temporary "advanced manufacturing investment credit" for investments in semiconductor manufacturing property, to be codified in Section 48D of the Internal Revenue Code.

The Section 48D credit amounts to 25% of qualified investment related to an advanced manufacturing facility — that is, a facility with the primary purpose of manufacturing semiconductors or semiconductor manufacturing equipment.

Qualified property is tangible property that meets all the following requirements:

- Qualifies for depreciation or amortization
- Is constructed, reconstructed, or erected by the taxpayer or acquired by the taxpayer if the original use of the property begins with the taxpayer
- Is integral to the operation of the advanced manufacturing facility

Qualified property also can include a building, a portion of a building (other than a portion used for functions unrelated to manufacturing, such as administrative services), and certain structural components of a building.

The credit is available for qualified property placed in service after December 31, 2022, if construction begins before January 1, 2027. If construction began before the CHIPS Act was enacted, however, only the portion of the basis attributable to construction begun after enactment is eligible.

Inflation Reduction Act Summary and Tax Provisions

With $430 billion in provisions, the IRA includes new taxes to support these efforts. However, the bill is not designed to raise taxes on small businesses or taxpayers earning less than $400,000 per year, but instead targets wealthier taxpayers.

The first target is U.S. corporations (other than S corporations) that have more than $1 billion in annual earnings over the previous three years. While the current corporate tax rate is 21%, it's been well documented that many such companies pay little to no federal income tax, due in part to deductions and credits. The IRA imposes a corporate alternative minimum tax of 15% of financial statement income (also known as book income) reduced by, among other things, depreciation and net operating losses. The new minimum tax is effective for tax years beginning after December 31, 2022.

As a result of last-minute negotiations, private equity firms and hedge funds are exempt from the minimum tax. They could have been covered by a provision that generally includes subsidiaries when determining annual earnings. The tradeoff is that the IRA now will extend the excess business loss limitation for certain businesses for two years.

Although the initial bill language also closed the so-called "carried interest" loophole that permits these interests to be taxed as long-term capital gains rather than ordinary income, the loophole ultimately survived. To make up for the lost revenue, the IRA imposes a 1% excise tax on the fair market value when corporations buy back their stock.

The IRA also provides about $80 billion over 10 years to fund the IRS and improve its "tax enforcement activities" and technology. Notably, the IRS budget has been dramatically slashed in recent years, dropping by 20% in 2020, compared to 2010. The Congressional Budget Office (CBO) estimates that the infusion of funds will allow the IRS to collect $203 billion over the next decade from corporations and wealthy individuals.

Inflation Reduction Act Climate and Energy Tax Credits

The legislation includes new, extended, and increased tax credits intended to incentivize both businesses and individuals to boost their use of renewable energy. For example, the legislation provides tax credits to private companies and public utilities to produce renewable energy or manufacture parts used in renewable projects, such as wind turbines and solar panels. Clean energy producers that pay a prevailing wage may qualify for tax credits. The IRA also provides incentives for making commercial buildings and residences more energy efficient.

Clean Vehicle Tax Credits

Although the provisions in the IRA generally aren't effective until 2023 (and beyond), the legislation did make notable changes to portions of the electric vehicle credits effective this year. The changes are complex, and phase in over time. If you are in the market for an electric vehicle, the rules are worth reviewing.

North American assembly requirement. One of the new rules is in effect right now. To qualify for the clean vehicle credit, final assembly of the vehicle must take place in North America. After determining which makes and models generally meet the North America assembly requirement from this list, double-check particular vehicles by entering its vehicle identification number (VIN) into the decoder. There is also a list of makes and models that generally should meet the requirement, but you should double-check for any particular vehicle by using the VIN decoder.

Manufacturer limitation. Effective January 1, 2023, the manufacturer limitation is going away. Under the manufacturer limitation, once a manufacturer had sold 200,000 electric vehicles, a taxpayer's ability to take a tax credit for vehicles produced by that manufacturer begins to phase out. Taxpayers are currently prevented from taking the electric vehicle credit for automobiles manufactured by General Motors and Tesla. Starting at the beginning of 2023, taxpayers will be able to take the credit for GM and Tesla vehicles once again, but see the manufacturer's suggested retail price (MSRP) limits below.

Calculation of the credit. The way the credit is calculated is changing later this year. The IRS is expected to issue regulations implementing the new rules. Under the previous rules, the base amount of the clean vehicle credit is $2,500 per vehicle. The allowable credit increases to $7,500 per vehicle based on a formula which increases the credit by $417 for every kilowatt hour of battery capacity more than five.

Under the new rules, the amount of the credit will be based on two separate requirements, each one based on where the vehicle's battery is sourced:

- Taxpayers get a $3,750 credit for meeting the critical minerals requirement (mandating that a minimum percentage of the minerals contained in the battery be sourced in the United States or a country with which the United States has a free trade agreement in effect).
- Taxpayers also can get a $3,750 credit for satisfying the battery component requirement (dictating that a minimum percentage of the value of the components of the battery be manufactured or assembled in North America).

Taxpayers can satisfy either or both requirements, for either a $3,750 credit (if only one requirement is satisfied) or a $7,500 credit (if both requirements are satisfied).

New qualified fuel cell motor vehicle. Effective January 1, 2023, the credit will also be available for new qualified fuel cell motor vehicles. New qualified fuel cell motor vehicles are vehicles propelled by power derived from one or more cells that convert chemical energy directly into electricity by combining oxygen with hydrogen fuel, and that meet certain additional requirements. New qualified fuel cell motor vehicles must meet the North American final assembly requirement. They can qualify for either a $3,750 or $7,500 credit based on whether they satisfy one or both of the critical minerals requirement and battery components requirements.

Modified adjusted gross income limitation. Starting on January 1, 2023, your ability to take the electric vehicle credit will be limited based on your modified adjusted gross income (MAGI). MAGI is adjusted gross income (AGI) with adjustments for income received from U.S. territories. For most taxpayers, MAGI will be equal to AGI. You may not take the credit if your MAGI exceeds the threshold amount. The threshold amount is:

- For married taxpayers filing a joint return or a surviving spouse, $300,000
- For taxpayers filing as head of household, $225,000
- For all other taxpayers (single, married filing separately), $150,000

These amounts are not adjusted for inflation. If your MAGI exceeds this amount, you should buy the electric vehicle before the first of the year.

MSRP limitation. Also starting on January 1, 2023, vehicles will not be eligible for the credit if they exceed an MSRP limit: $80,000 for vans, pickup trucks, and sport utility vehicles; $55,000 for other vehicles. This means that if you are looking at a higher-end electric vehicle, you need to act by the end of December.

Unfortunately, the manufacturer limitation (see above) will not go away until January 1, 2023, so you will not be able to claim the credit for higher-end GM and Tesla vehicles that exceed the MSRP limits.

Transition rule. Finally, if you had a binding contract to purchase an electric vehicle as of August 15, 2022, or earlier, you can choose to apply the old rules.

The IRA also creates tax credits for used and commercial electric vehicles in 2023. The credit for qualified commercial clean vehicles is subject to different requirements than consumer vehicles, some of which have not yet been finalized.

California's Energy Incentives

The IRA provides federal tax rebates and credits, but California also offers incentives for energy efficiency and environmental conservation, including turf replacement and water rebates, a solar property new construction property tax reassessment exclusion, and energy conservation subsidies for public utilities who provide incentives to customers.

California offers an electric vehicle rebate of up to $7,000 for the purchase or lease of a new plug-in hybrid electric vehicle, battery electric vehicle, or a fuel cell electric vehicle. Taxpayers are not eligible for the rebates if their gross annual incomes are above certain thresholds.

For CHIPS Act or IRA Questions, Connect With Your Seiler Tax Advisor

Both the CHIPS Act and the IRA are sweeping pieces of legislation that affect many sectors of U.S. business, as well as most individual taxpayers. Additional information, guidance, and regulations related to their numerous provisions are inevitable. Your Seiler tax advisor will keep you up to date on the developments that could affect your finances and federal tax liability.