

## The Inflation Reduction Act: What You Need to Know



**Deb Lifshey**

MANAGING DIRECTOR



**Margaret H. Black**

MANAGING DIRECTOR

After months of negotiations and countless amendments, the Inflation Reduction Act (the “Act”) was passed by the Senate on August 7. The Act, a downsized version of the House’s earlier Build Back Better Act (“BBBA”), is intended to target climate change, healthcare, taxes, and inflation. It is expected that the Act will be signed into law by the end of August.

For our clients, it’s important to know that unlike the proposed legislation of the BBBA, the Act does not include legislation *directly* impacting executive compensation (although like all legislation, it may have some derivative impact). Provisions in the BBBA that might have increased taxes on wealthy individuals were cut in the Senate negotiation process. However, the final provisions do include major corporate tax and healthcare-related provisions that boards will want to be aware of, some of which are outlined below. We also include some “behind the curtain” tidbits to help clarify how a few of the unexpected provisions were included in the final legislation.

### Noteworthy Tax Provisions

The Act’s tax provisions primarily impact large profitable companies and adhere to President Biden’s campaign vow not to raise taxes on households earning less than \$400,000 per year or on small businesses. Significantly, the provisions in BBBA that would have increased taxes on wealthy individuals, such as the surcharge on high income taxpayers, expansion of the net Investment Income tax, and restrictions on retirement plans of the wealthy, were stripped out of the final draft.

#### ■ Corporate Profits Minimum Tax

- The Act imposes a 15 percent minimum tax on corporate book income for corporations (other than S Corporations, regulated investment companies, and real estate investment trusts) that report an average of more than \$1 billion of adjusted financial statement income over a three-year period.
- Last-minute negotiations resulted in the passage of an amendment so that the minimum tax will not apply to unrelated companies that are otherwise below the threshold but are under common ownership of an investment fund, where the aggregation of their earnings might put them over the \$1 billion threshold. This exclusion was funded by extending the excess business loss limitations out two years (discussed in more detail below).
- The new tax would be effective for tax years beginning after December 31, 2022.

#### ■ One Percent Excise Tax on Stock Buybacks

- The Act generally imposes a one percent excise tax on publicly traded US
-

corporations (and certain US subsidiaries of publicly traded non-U.S. corporations) on the value of any stock that is repurchased by the corporation. The Act contains technical exceptions to the excise tax, including for when the repurchase is part of a reorganization for tax purposes.

- This new tax was incorporated into the Act as a result of Democratic negotiations with Senator Kyrsten Sinema. Earlier versions of the Act proposed modifying the rules for carried interests (i.e., the special tax treatment that hedge fund managers and private equity executives get on the investment gains they take as compensation). After Ms. Sinema objected, the carried interest modifications were replaced with the stock buyback tax.
- The new tax would be effective for tax years beginning after December 31, 2022.
- **Extension of Excess Business Loss Rules**
  - The Act extends the current cap on deductions for excess business losses applicable to non-corporate taxpayers by two years, extending the cap on deductions through 2028. Currently, deductions for excess business losses cannot exceed \$270,000 (for single filers) or \$540,000 (for married spouses filing jointly). The extension impacts owners of closely-held businesses who integrate business decisions with their own tax circumstances.
  - The current limitation will be extended through tax years beginning before January 1, 2029.
- **Energy and Climate Change Investments and Tax Credits**
  - The Act includes numerous investments in climate protection, including tax credits for households to offset energy costs, investments in clean energy production, and tax credits aimed at reducing carbon emissions.
  - **IRS Funding**
  - The Act includes an \$80 billion increase in IRS funding over 10 years. Over half of the amount (\$45.6 billion) is targeted for enforcement matters. Other key areas of funding include operations support, business systems modernization, and taxpayer services.

## Noteworthy Health Care Provisions

The Act includes provisions designed to reduce governmental and individual health care costs such as:

- **Affordable Care Act Subsidy Extension**
  - The Act extends the Affordable Care Act (ACA) program, currently set to expire at the end of the year, through 2025. Under current law, ACA medical insurance premiums are subsidized by the federal government, so this extension is meant to allow eligible individuals and families to continue to benefit from lower health care premiums.
- **Prescription Drug Reform**
  - The Act requires Medicare to negotiate prices for certain prescription drugs beginning in 2026.
  - Beginning in 2023, the Act requires drug companies to pay rebates to Medicare if prices paid by Medicare increase at an annual rate that is faster than inflation.
- **Medicare Out-Of-Pocket Costs**
  - The Act includes several provisions that will impact out-of-pocket costs paid by Medicare recipients including:
    - For the years 2023-2025, limits insulin copays to \$35 a month, after which it

will be the lesser of \$35, 25 percent of the established maximum fair price, or 25 percent of the negotiated price.

- Starting in 2025, limits the out-of-pocket drug costs for Part D patients to \$2,000 per year.
- Starting in 2024, eliminates the five percent coinsurance payment Medicare patients pay once the drug costs qualify for catastrophic coverage.
- For the years 2024–2029, limits premium rate increases for Part D to no more than six percent annually.

## Limited Impact on Compensation Programs and Planning

Since the provisions in BBBA that would have increased taxes on wealthy individuals were stripped from the final legislation, we do not anticipate major changes to compensation programs and planning as a result of the Act's passage. It is possible that the funding of IRS enforcement activities could result in more audits focused on the tax compliance of complicated executive pay provisions such as IRC Sections 409A, 162(m), 280G, 4999, and 4960, but this remains to be seen.

We will continue to review and monitor the Act's impact on pay practices as further guidance is provided.

## About the Authors

Deborah Lifshy is a managing director at Pearl Meyer, where she specializes in advising clients on compensation matters from a legal perspective including securities disclosure, taxation and corporate governance issues, negotiation contracts, and reasonableness opinion letters.

Margaret Black is a managing director at Pearl Meyer and a member of the firm's Technical Services team. She has consulted for over 25 years in the field of tax and over 20 years on all aspects of compensation and benefits matters. Margaret has extensive experience in issues related to corporate acquisitions, divestitures and restructurings, as well as with change-in-control provisions, IRC Sections 280G, 409A, and 162(m) compliance.

## About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.