

# Tax Reform in July: Key provisions of the newly announced Inflation Reduction Act of 2022

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On July 27, 2022, Senator Joe Manchin (D-WV) and Senate Majority Leader Chuck Schumer (D-NY) announced that they have reached an agreement on a reconciliation package that stems from negotiations on the *Build Back Better Act*.<sup>[1]</sup> H.R. 5376, or the *Inflation Reduction Act of 2022*, would, among other things: (1) establish a 15% corporate minimum tax; (2) provide for increased Internal Revenue Service (“IRS”) enforcement; and (3) modify the carried interest rules to apply short-term capital gains rates.

A discussion of the key provisions of the *Inflation Reduction Act of 2022* (the “Act”) can be found below:

## KEY PROVISIONS

### Corporate

- **Corporate Alternative Minimum Tax.** The Act creates a Corporate Alternative Minimum Tax (“AMT”) equal to 15% of financial statement income, less foreign tax credits, that applies to corporate taxpayers meeting an average annual adjusted financial statement income test – *i.e.*, the corporate taxpayer’s average adjusted financial statement income for a three-year period exceeds \$1 billion. The Act also contains rules for the computation of financial statement income for the purposes of this determination and authorizes the Secretary of the Treasury to promulgate additional regulations and guidance relating to the effect of these rules.
- **No Implementation of Minimum Tax on Foreign Earnings.** Legislation previously rejected by Senator Manchin would have raised the current tax rate on Global Intangible Low-Taxed Income (“GILTI”) from 10.5% to 15% and amended the GILTI regime to operate on a country-by-country, rather than worldwide, basis. This change is notably absent from the Act. The former proposal to change the GILTI regime was intended to reform the U.S. tax system to fall in line with the OECD’s Pillar 2 global minimum tax project. Treasury and at least some officials within the OECD had argued that a reformed GILTI regime would constitute a qualified Income Inclusion Rule.

Countries adopting Pillar 2’s Undertaxed Payments Rule will be able to impose top-up taxes on foreign-parented corporations in their jurisdiction if the parent’s jurisdiction fails to implement a qualified Income Inclusion Rule, as that term is used defined for purposes of Pillar 2. As the Act likely leaves the U.S. without a qualified Income

Inclusion Rule, it is conceivable that other countries could apply the Pillar 2 minimum tax to U.S. multinationals via their subsidiaries to claim additional tax revenue that the U.S. could have otherwise collected.

- **Higher Taxes on Carried Interest.** The Act contains provisions closing the so-called “carried interest loophole.” Current law taxes the performance-based compensation paid to managers of certain investment partnerships at long-term capital-gains rates rather than as ordinary income provided that a three-year holding period is met. The Act would generally (except in limited circumstances) require partners to hold investments for a period of five years in order to qualify for the long-term capital-gains rate.

## IRS Appropriations & Enforcement

- **Taxpayer Services.** The Act appropriates \$3.18 billion for necessary expenses for the IRS to provide: (1) taxpayer services, including pre-filing assistance and education; (2) filing and account services; (3) taxpayer advocacy services; and (4) other services.
- **Enforcement.** The Act appropriates \$45.6 billion for necessary expenses for the IRS to: (1) determine and collect taxes; (2) provide legal and litigation support; (3) conduct criminal investigations (including investigative technology); (4) provide digital asset monitoring and compliance activities; (5) enforce criminal statutes related to violations of the Internal Revenue Code and other financial crimes; (6) purchase and hire passenger motor vehicles; and (7) provide other services.
- **Operations Support.** The Act appropriates \$25.3 billion for necessary expenses relating to supporting IRS operations.
- **Business Systems Modernization.** The Act appropriates \$4.75 billion for necessary expenses relating to the modernization of the IRS, which includes the development of callback technology and other technology for purposes of providing a more personalized customer service.
- **Task Force to Design an IRS-Run Free “Direct File” Tax Return System.** The Act appropriates \$15 million for the IRS to deliver to Congress a report detailing: (1) the cost (including options for differential coverage based on taxpayer adjusted gross income and return complexity) of developing and running a free, direct e-file tax return system; (2) taxpayer opinions, expectations, and level of trust for a free, direct e-file system; and (3) the opinions of an independent third-party on the overall feasibility and capacity of the IRS to implement an e-file system.
- **United States Tax Court.** The Act appropriates \$153 million for the Tax Court.
- **No Tax Increases on Certain Taxpayers.** The Act states that none of the IRS appropriations listed above will result in an increase in taxes on taxpayers with taxable income below \$400,000.

## Key Takeaways

- The Act contains some of the most significant changes to tax policy and administration since the Tax Cuts and Jobs Act in 2017.
- Senate leadership intends to raise the Act for consideration under the rules of budget reconciliation before the Senate breaks for its August recess.
- It is expected that there will not be further changes to the Act, especially given the prior posture of Senator Manchin on tax reform.
- Reconciliation bills cannot be filibustered. The Democrats’ lack of a 60-vote majority in the Senate needed to overcome a filibuster is irrelevant to the passage of the Act.

Winston & Strawn will continue to monitor any developments relating to the *Inflation Reduction Act of 2022*.

For further information, please contact the authors or your Winston relationship attorney.

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<sup>11</sup> Winston & Strawn Blog Post: “Senate Finance Committee “Build Back Better Act” Markup,” Dec. 14, 2021.

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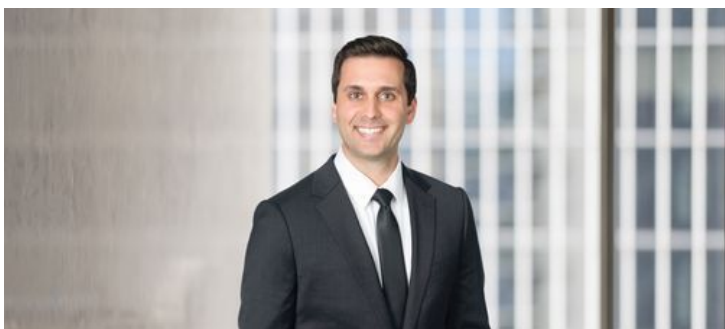
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