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One Way or Another Inflation Reduction Act Impacts Your Wealth Plan

The Inflation Reduction Act is about to become law: depending on when you read this the President may have already signed. The $433 billion dollar bill is a dramatically reduced version of the original $3.5 trillion Build Back Better Act. The legislation attempts to reduce prescription drug prices for Medicare recipients, support climate projects and energy initiatives through tax credits and renewable energy projects.

The act contains a few corporate tax changes and none that increase personal income or estate taxes. Included in the bill is a minimum tax of 15% on large firms which is estimated to impact a subset of companies each year. The corporate tax does not directly impact taxpayers on their individual returns. However, higher corporate taxes typically add cost and may result in lower earnings for shareholders or lower wages paid to workers. Lower earnings likely negatively affect equity prices and may reduce portfolio returns. The result may impact your long-term wealth plan.

The act includes a 1% excise tax on stock buybacks from large corporations. Wall Street analysts do not seem to be concerned with the tax. Some analysts have noted the tax could motivate companies to issue dividends over repurchasing shares to improve equity prices.

$80 billion is slated to go to the IRS over the next decade to ramp up enforcement. Charles Rettig, the IRS commissioner, recently told congress that the collection agency would not increase audits of households earning less than $400k. Treasury Secretary Yellen's directions to the IRS supports Rettig's comment. This investment in the IRS likely translates into increased audits on high income taxpayers. Audits on wealthy taxpayers are already ramping up: the percentage of 2019 tax returns that were audited on filers with income from $500k to $10mm doubled between 9/30/21 and 5/1/2022. The audit rate more than quadrupled for those with greater than $10mm of income according to data publish by the Treasury Inspector General for Tax Administration.

Medicare enrollees will likely benefit from the act. The bill contains measures to lower prescription drug prices by allowing the government to negotiate prices with pharmaceutical companies starting in 2026. Another provision is that out-of-pocket drug costs will be capped at $2,000 annually starting in 2025, currently there is no limit. Also included in the bill is a 3-year extension of the Premium Tax Credit (PTC) allowing high income households to continue to take advantage of the refundable tax credit to help cover insurance premiums.

The bill also extends the $7,500 electric vehicle (EV) tax credit from 2023 through the end of 2032 and removes the per manufacturer limit of 200k vehicles. There are personal income limits and other restrictions, and this bill seems to be aimed at encouraging mid to mid-high-income taxpayers to purchase EVs assembled in the US. If you plan to invest in reducing your carbon footprint, this bill has a few incentives that offer rebates and tax credits for various household clean energy projects and appliance purchases.

The revision on how carried interest is taxed was not included: private equity managers will continue to pay tax at the favorable capital gains rate instead of the higher ordinary income rates. The State and Local Tax (SALT) was not changed, the cap remains at $10,000. Many speculated that the SALT cap would increase or be eliminated entirely.

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