# State Tax Implications of the Inflation Reduction Act

On August 16, 2022, the Inflation Reduction Act (the Act) of 2022 was signed into law.[1] The Act made several key tax law changes including: establishing a corporate alternative minimum tax, permitting taxpayers to sell energy tax credits to third parties, and extending the expiration date and phase down dates for the investment tax credit for solar (ITC) and production tax credit for wind (PTC). With the Internal Revenue Code receiving yet another set of legislative changes, after the Tax Cuts and Jobs Act (TCJA) in 2017 and the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) in 2020, how states incorporate the Act into their own tax laws is an important issue taxpayers must consider when determining the full impact of the Act on their business operations.

## State Conformity to Internal Revenue Code

States generally incorporate the Internal Revenue Code into their own tax laws through two main methodologies, "rolling conformity" and "static conformity." States that utilize "rolling conformity" adopt the Internal Revenue Code as amended and do not need the state legislature to act for new provisions of the Internal Revenue Code to be incorporated into the states' tax laws. Conversely, states that utilize "static conformity" adopt the Internal Revenue Code as of a specific date. Here, the state legislature must act to advance the conformity date for any new provisions of the Internal Revenue Code to be incorporated into the state's tax laws. It should be noted that a small number of states utilize neither rolling conformity nor static conformity, but rather conform to only specific provisions of the Internal Revenue Code or adopt changes to the Internal Revenue Code only if certain conditions are met such as revenue impact.

## Corporate Alternative Minimum Tax

The Act introduces a new 15% corporate alternative minimum tax (corporate AMT) on the adjusted financial statement income of certain large corporations for tax

[1] H.R. 5376 (2017); The official legal name of the new law is "An Act to provide for reconciliation pursuant to title II of S. Con. Res. 14."

years beginning after December 31, 2022.[2] In those states that impose a corporate AMT, the majority do not calculate tax due based on a corresponding alternative minimum tax liability determined at the federal level. In these instances, the corporate AMT provisions found in the Act are not likely to have a significant state tax impact. On the other hand, if the state liability is tied to the liability determined at the federal level, state conformity to the Internal Revenue Code will be important in calculating alternative minimum tax liabilities.

For example, Alaska imposes an alternative minimum tax at a rate of 18% of the applicable federal alternative minimum tax.[3] Alaska utilizes rolling conformity to the Internal Revenue Code.[4] As a result, Alaska's alternative minimum tax liability beginning in tax years after December 31, 2022 is likely based on the corporate AMT of the Act.[5] Another state that imposes an alternative minimum tax that references the federal alternative minimum tax provisions is California.[6] California utilizes static conformity and conforms to the Internal Revenue Code as of January 1, 2015.[7] Therefore, the corporate AMT provisions would not be incorporated for California purposes unless state legislative action is taken.

Another example of state conformity to the Internal Revenue Code interacting with the corporate AMT provisions can be found in Florida. Florida currently conforms to the Internal Revenue Code as of January 1, 2022.[8] While Florida utilizes static conformity to the Internal Revenue Code, the Florida legislature typically advances its conformity to the Internal Revenue Code annually. For tax years before 2018, Florida imposed an alternative minimum tax equal to 3.3% of the federal alternative minimum tax imposed on corporate taxpayers.[9] Specifically, the Florida statutes note that for those taxpayers subject to the alternative minimum tax as defined in IRC section 55, "taxable income" for purposes of the Florida alternative minimum tax means the alternative minimum taxable income as defined in IRC section 55(b)(2).[10] Furthermore, a taxpayer is not liable for the Florida alternative minimum tax unless the taxpayer's federal tax return, or related federal consolidated tax return, reflect a liability for the alternative minimum tax as defined in Internal Revenue Code section 55(b)(2).[11]

While Florida's statutes contemplate an alternative minimum tax, when Florida advanced its conformity to a version of the Internal Revenue Code after 1/1/2018, it automatically incorporated the repeal of the federal alternative minimum tax contained within the TCJA. As a result, the Florida alternative minimum tax statutory provisions were rendered ineffective as without a federal alternative minimum tax, there was no tax base upon which Florida could assess its alternative minimum tax. As we move into a new calendar year, Florida may look to update its conformity to the Internal Revenue Code once again. If Florida advances its conformity date to the Internal Revenue Code, i.e., January 1, 2023, and makes no other changes, the Florida alternative minimum tax provisions would be revived— requiring taxpayers to once more consider as they complete corporate income tax filings in Florida.[12]

For multistate taxpayers, the examples of Alaska, California, and Florida highlight the importance of considering state conformity to the Internal Revenue Code. After the Act was passed, the Joint Committee of Taxation estimated the corporate AMT would raise approximately $222.25 billion over the 10-year budget window. Mechanisms to generate additional state revenues, especially considering revenue shortfalls caused by the health pandemic over the last couple of years, is a shared goal across state legislatures. Taxpayers should continue to monitor state responses to the Act such as changes to conformity to the Internal Revenue Code or the enactment of state specific legislation that may seek to drive additional state tax funding.

## Energy Credits & Transferability

For tax years beginning after 2022, the Act provides that a taxpayer may elect to transfer the PTC and/or ITC to an unrelated taxpayer for a cash payment and exclude such sale proceeds from gross income.[13] The transferability election must be made annually and separately with respect to each facility.

[2] 26 U.S.C.A. § 55(b).

[3] Alaska Stat. § 43.20.021(f).

[4] Alaska Stat. § 43.20.021(a); Alaska Stat. § 43.20.300.

[5] Alaska Stat. § 43.20.021(a); Alaska Stat. § 43.20.300.

[6] Cal. Rev. & Tax. Cd. §§ 23400; 23455.

[7] Cal. Rev. & Tax. Cd. § 17024.5(a)(1).

[8] Fla. Stat. Ann. § 220.03(1)(n).

[9] Fla. Stat. Ann. § 220.11; Fla. Stat. Ann. § 220.13(2)(k).

[10] Fla. Stat. Ann. § 220.13(2)(k).

[11] *Id.*

[12] On May 5, 2023, Florida HB 7063 unanimously passed the Florida Senate and was sent to the Governor for signature. If signed, HB 7063 will advance Florida's IRC conformity date to January 1, 2023. Furthermore, HB 7063 would likely include the corporate AMT as part of the determination of Florida corporate income tax. Once signed, it is anticipated the Florida Department of Revenue will issue a Tax Information Publication addressing the impact of HB 7063 – including how taxpayers should calculate corporate AMT for Florida corporate income tax purposes.

Transferability has never been available for federal tax credits, and it remains to be seen how the market for the tax credits and the associated tax credit sale transactions develop.

From a state perspective, the starting point for determining state taxable income is federal taxable income. Under the Act, proceeds from the sale of federal energy credits would not be included in the state taxable income starting point—assuming the state conforms to the current version of the Internal Revenue Code. In states that have static conformity to the Internal Revenue Code as of a date prior to August 16, 2022, or if a state decouples from Internal Revenue Code section 30D, a situation arises where the proceeds from the transfer of PTC or ITC credits may create state taxable income, while being excluded from federal taxable income. Furthermore, if a state should require the proceeds be included in the taxpayer's state taxable income base, then consideration should also be given as to how those proceeds should be represented in the taxpayer's state apportionment formula. The sale of credits is likely not considered the sale of tangible personal property, and therefore, taxpayers will need to pay special attention to the state rules that control how to properly source the sale of intangible assets.

Aside from an income tax perspective, some states impose a tax on gross receipts—which may not necessarily be tied to taxable income. In these states, further examination is required to determine whether gross receipts received from the sale of PTCs and/or ITCs would be subject to a state gross receipts tax—even though the taxable income generated from that sale may be exempt from an income tax perspective.

For instance, the Ohio Commercial Activity Tax is imposed on taxpayers with gross receipts sitused to Ohio.[14] Ohio defines "gross receipts" as the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person, including the fair market value of any property and any services received, and any debt transferred or forgiven as consideration.[15] Ohio provides specific exclusions from the definition of "gross receipts" but does not exclude the sale of intangible assets, such as credits.[16] Ohio currently conforms to the Internal Revenue Code as of February 17, 2022 and therefore does not incorporate the provisions of the Act.[17] Therefore, the version of the Internal Revenue Code in operation for Ohio tax purposes is without exclusion from gross income the sale of ITCs and PTCs. As a result, without future action by the Ohio legislature, the Ohio Commercial Activity Tax base would likely include the gross receipts generated from the sale of ITCs and/or PTCs, even though the gross income from those sales would be excluded for federal income tax purposes.

Another state that imposes a gross receipts tax is Oregon. Effective for tax years beginning on or after January 1, 2020, Oregon imposes a Corporate Activity Tax on taxpayers with commercial activity in Oregon that exceeds $1,000,000.[18] For purposes of this tax, Oregon defines "commercial activity" as the total amount realized by a person, arising from transactions and activity in the regular course of the person's trade or business, without deduction for expenses incurred by the trade or business.[19] Similar to Ohio, Oregon provides a list of excluded items from its definition of "commercial activity" but does not explicitly address gross receipts that yield exempt gross income.[20] Given the breadth of how Oregon defines commercial activity and with no explicit exclusions on point, Oregon may also seek to include in its Corporate Activity Tax base the proceeds from sales of ITCs and PTCs.

The transferability of federal energy credits will impact the project finance landscape by changing the way developers and their financial partners can share the economic benefit of the incentives. If taxpayers have plans on generating new ITC or PTC credits with the intent to sell those credits, additional consideration should be given on where a project is placed and how that state conforms to the Act. This will help to avoid any surprises where income excluded from tax at the federal level may be subject to tax at the state level.

On a related point, taxpayers should also analyze whether state specific credits are available based on the type of project being commenced in the state. With the Act generating a lot of attention of the credits available at the federal level, state credits can provide additional tax benefits that taxpayers can take advantage of.

## Energy Credits and Basis Adjustments

If taxpayers claim an ITC, the basis of property must be reduced by 50% of the credit amount.[21] While not a new provision of the Act, it is important to remember how state depreciable basis interacts with

[13] 26 U.S.C.A. § 30D(g)(5).

[14] Ohio Rev. Code Ann. § 5751.01; Ohio Rev. Code Ann. § 5751.03.

[15] Ohio Rev. Code Ann. § 5751.01(F)(1).

[16] Ohio Rev. Code Ann. § 5751.01(F)(2).

[17] Ohio Rev. Code Ann. § 5701.11.

[18] Or. Rev. Stat. Ann. § 317A.116; Or. Rev. Stat. Ann. § 317A.125.

[19] Or. Rev. Stat. Ann. § 317A.100(1)(a)(A).

[20] Or. Rev. Stat. Ann. § 317A.100(1)(b).

[21] 26 U.S.C.A. § 50(c)(3)(A).

the basis utilized for federal depreciation purposes. In most cases, state depreciable basis will reference the depreciable basis utilized at the federal level. For instance, New York provides that "Depreciable basis is the cost or other basis reduced by the part of the basis you elected to amortize or expense under IRC section 179, and any federal investment credit subtracted when computing the federal unadjusted basis of the asset.[22]" Given the mechanics of determining depreciable basis in New York, any reduction in basis at the federal level relating to ITC credits awarded, is likely to also reduce the New York asset basis. Conversely, California explicitly decouples from Internal Revenue Code section 48, the section which authorizes the ITC. Because of this, depreciable basis for California purposes is without consideration of any reduction required by claiming an ITC.

Another scenario taxpayers are likely to encounter is when a state does not provide explicit guidance on what the applicable state depreciable basis should be for an asset the taxpayer claimed an ITC for. In those instances, taxpayers will need to analyze how the state specifically conforms to the Internal Revenue Code and may need to refer to tax return instructions to help determine the appropriate answer. A specific example of this can be seen in Georgia. For taxable years beginning on or after January 1, 2021, Georgia conforms to the Internal Revenue Code of 1986 with enumerated exceptions.[23] Georgia decouples from federal bonus depreciation but otherwise generally conforms to federal depreciation.[24] Additionally, according to Georgia's tax return instructions regarding depreciation, taxpayers shall calculate basis for depreciation in accordance with IRS instructions.[25] As previously noted, if taxpayers claim an ITC the basis of property must be reduced by 50% of the credit amount.[26] While Georgia conforms to the IRC of 1986, with enumerated exceptions – Georgia does not decouple with IRC § 50.[27] As such, it is likely that a Georgia taxpayer taking an ITC must calculate its Georgia basis congruent to the federal 50% basis reduction.

As taxpayers generate federal tax credits that require adjustments to property basis, a review of the state conformity provisions to the Internal Revenue Code is important to ensure the proper basis is utilized in determining state depreciation expense deductions.

## Contact us

Have questions? Please reach out to your KPMG advisers or the authors of this article:

**Larry Joseph** (lgjoseph@kpmg.com) is a senior manager in the State and Local Tax (SALT) practice and focuses on SALT issues facing taxpayers in the power and utility industry, especially those taxpayers in the renewable energy sector.

**Glenn Todd** (gtodd@kpmg.com) is a SALT and senior lead tax principal. Glenn serves as the National Tax Industry Leader for Power and Utilities practice.

For information about KPMG services related to the tax implications of renewable energy projects, visit the visit the KPMG National Renewable Energy Group webpage.

22 New York Form Instructions, IT-339
23 Ga. Code Ann. § 48-1-2(14).
24 Id.
25 Ga. Form 4562 – Instructions.
26 26 U.S.C.A. § 50(c)(3)(A).
27 Ga. Code Ann. § 48-1-2(14).