How the Inflation Reduction Act Impacts Farmers

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The Inflation Reduction Act became law as of August 16, 2022. The Act is another sprawling "reconciliation" bill, coming in at 730 pages. Within that text are a number of provisions that will directly impact the agribusiness industry. This article briefly highlights those provisions.

Extension of the Excess Business Loss Rule

The Excess Business Loss ("EBL") Rule is relatively new. It was created as part of the Tax Cuts and Jobs Act enacted in 2017 and has the effect of capping net operating losses (NOLs) to an inflation-adjusted benchmark ($540,000 for 2022). The EBL Rule was supposed to automatically go away in 2025. It was extended through 2026 as part of the American Rescue Plan (one of the Covid-related stimulus bills), and is not extended an additional two years, through the end of 2028.

The effect of this rule is that farmers will not be able to use big losses all at once. The EBL Rule forces income to be recognized in earlier tax years and to spread the losses over subsequent tax years. Keep in mind that changes to the net operating loss rules passed in 2017 also limit the use of NOLs. Farmers are now limited to offsetting 80% of taxable income (instead of 100%). The bottom line is that losses are not as useful as they used to be and generating a large NOL in one year to offset future income may not be advisable for the foreseeable future.

Relief Program for At-Risk Farmers

The American Rescue Plan contained a $4 billion program to forgive USDA loans taken by socially disadvantaged farmers. This legislation was immediately tied up in litigation. The Act completely repeals these provisions and replaces them with a $3.1 billion program targeted to any farms facing financial hardship. Relief would be available to farmers with loans that are through, or guaranteed by, the USDA. The Act provides little specifics and defers design and implementation of the program to the USDA. A separate pool of $2.9 billion will be available for underserved farmers and those who have been subject to discrimination. Importantly, "underserved" farmers is defined to include beginning farms and veterans. Again, implementation and eligibility rules are largely delegated to the USDA.

Revised Energy Tax Credits

The Act expands alternative energy activities that are eligible for the credit. One notable inclusion is biogas facilities, which includes anerobic manure digesters. Credits for digester projects were previously only available under a gasification project credit. Those credits are largely allocated and no longer available.

The investment tax credit (ITC) is relatively modest at only 6%. However, if the project uses "prevailing wages" for the area and offers an apprenticeship program, the credit increases to 30%. Prevailing wages are the wages contractors must offer their employees when doing business with a government agency. In Michigan, prevailing wage rates are published annually by the Department of Labor and Economic Opportunity. Typically, these wage rates result in significantly higher construction costs that may exceed the net economic benefit of the tax credit. Farmers should carefully scrutinize forecasted construction costs and the anticipated credit before proceeding with digester construction at prevailing wage rates.

Finally, the Act permits taxpayers to sell investment credits to an unrelated third party without paying tax on the sale. For example, a $30 million manure digester may receive a 6% tax credit of $1.8 million. Instead of using this credit, the taxpayer could sell it to an unrelated third party (likely at some discount) and receive tax-free liquidity instead. Selling the credits will only be beneficial for taxpayers that have a modest amount of taxable income each year and would be required to stretch the use of a large credit over several tax years.

More Auditors

The Act provides $80 billion to the IRS (the Service) to hire additional employees and update their systems. You may recall headlines in 2018 related to the Service's 60-year-old computer system failing to process returns on tax day. You may also recall various statements by the current administration to the effect that taxpayers with under $400,000 of taxable income will not be adversely affected by federal tax legislation. However, in a letter to the Service, Secretary Yellen indicated that the increased number of auditors must not cause "audit rates [to] rise relative to recent years." So, while the audit rate for the middle class will remain constant, if the number of auditors is going up, the number of audits will go up too. Coupled with an ever-increasing tax code, the need for competent tax advice is paramount.

To learn more about how this legislation will impact your operations specifically, contact your Foster Swift Agribusiness Attorney.