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BACKGROUNDER

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The Inflation Reduction Act: What Is It Good For?

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KEY TAKEAWAYS

The Inflation Reduction Act will likely increase the deficit and add to inflationary pressure, especially in the near term.

The law's massive boost in IRS funding was predicated on a measure of unpaid taxes that is flawed and exaggerated.

The legislation will dramatically expand taxpayer subsidies to the least taxed businesses—green companies—allowing them to skirt the law's new minimum tax.

The new law commonly known as the Inflation Reduction Act (IRA) has been touted as President Joe Biden's signature legislative achievement of 2022.[1] After seemingly fruitless negotiations gained steam in July, Biden ultimately signed the IRA into law on August 16, 2022.[2]

The purported objective of the law, taming inflation, seemed more pressing in the months prior to the bill being debated than in January 2023 when most of the provisions of the law took effect. The growth rate in the Consumer Price Index (CPI) reached a peak in June 2022, the same month that the Federal Reserve began a series of aggressive 75 basis-point increases in the federal funds interest rate meant to fight back inflation.[3] As the Federal Reserve has continued tightening the money supply, year-over-year inflation had already come down from 9.1 percent in June to 6.5 percent by December, before most of the law went into effect.[4]

Despite its name, most analysis of the legislation suggests the IRA will have no significant impact on inflation and, if anything, will *add* to price pressures through 2024.[5] Even Senator and former Democratic Presidential Candidate Bernie Sanders (I–VT) acknowledged during debate on the Senate floor that the bill would have a minimal impact on inflation.[6] Fittingly, the name, Inflation Reduction Act, was ultimately stripped from the legislation's title, which is now officially "Public Law 117–169."

If the IRA is not, in fact, designed to reduce inflation, what are the taxes and spending in the law meant to accomplish, and how should its success or failure be evaluated? This *Backgrounder* looks at four claims about the benefits of spending and taxes in the law and examines the veracity of those claims. The report concludes by offering policy alternatives aimed at better achieving these stated objectives.

Claim No. 1: The IRA Will Reduce the Deficit and Inflation.

To understand why the IRA was branded by its supporters as inflation-reduction legislation, one must understand why American voters were so concerned about inflation in the first place. Between the 2020 and 2022 fiscal years (FYs), the federal government spent more than $5 trillion more than the Congressional Budget Office (CBO) had projected in its January 2020 report.[7] However, as the government spent at a record clip and issued trillions of dollars of new government bonds to finance the spending spree, private investors were unable or unwilling to buy up all the new debt. Therefore, the Federal Reserve (Fed) accommodated nearly all the debt from the new unanticipated spending by purchasing it on the open market, adding to the money supply in circulation by trillions of dollars.

The oversupply of dollars in the economy ensured that interest rates remained near zero, which was intended, in theory, to avoid impeding private investment. However, while the Fed's accommodation meant that governments, households, and businesses had far more money to spend, there was no commensurate increase in economic production. Therefore, inflation spiked—a classic example of too many dollars chasing too few goods and services.

In the long run, governments can only raise revenue through taxes or printing new money. Borrowing to cover a deficit is only a smoothing mechanism that allows for a lag between when the government spends and when it eventually raises the revenue. Clearly, when governments resort to money-printing, inflation is driven up by the devaluation of currency already in circulation. New taxes on productive activities like working and investing can also add to inflation by reducing the production of goods and services.

When a government borrows to fund new spending, it also drives up inflation. Businesses must compete with government debt to attract scarce capital. Large volumes of new government debt ultimately drive up businesses' financing costs. As a result, fewer productivity-enhancing investments occur. Unchecked deficits can also lead to self-reinforcing inflation as expectations drive changes in the behavior of consumers, investors, and businesses. The expectation of inflation increases short-term consumer demand by encouraging people to spend quickly to avoid the lost purchasing power that would occur if they simply held onto cash and allowed inflation to devalue the currency. High expected inflation also makes investing riskier because of greater uncertainty about future price and tax levels.[8] As inflation becomes ingrained, long-term price and wage contracts further reinforce the high inflation. The net result of all of this is that when governments engage in deficit spending, demand outstrips supply, and prices rise. Once inflation is ingrained, it is not easily reversed.

The Build Back Better Act. Congress almost made inflation far worse by adding much more to deficit-financed federal spending.[9] The Build Back Better Act (BBBA)—a massive spending package that could have added a massive $3.0 trillion to the deficit over 10 years—passed the U.S. House of Representatives in November 2021 but stalled in the Senate in early 2022.[10] The BBBA failed because by 2022 many Americans had come to recognize the causal relationship between America's deficit-financed multi-trillion-dollar spending spree and the inflation that was wreaking havoc in the economy.[11] At least 51 Senators recognized that adding that much additional spending and deficits would have further fueled inflation in 2022 with devastating economic and political fallout.

With inflation as the public's top concern in the summer of 2022 (when inflation had only just begun to slightly recede),[12] supporters of a major spending package changed the narrative by portraying the scaled-back IRA legislation as an inflation-reduction bill. Supporters argued that Congress could bring down inflation by signing legislation that reduced the deficit—ignoring how increased taxes and regulations could inhibit supply and therefore add to inflation even if it achieved a fiscal surplus.

The inflation-reduction claims, then, hinged on CBO scoring that estimated that the IRA would achieve a small fiscal surplus during a 10-year budget window.[13] The surpluses, however, were backloaded into the last half of the 10-year window, and significant deficits were only avoided with new taxes, mostly imposed on businesses. Given the legislation's lack of near-term deficit reduction and given that it adds to business costs, there was no plausible reason to expect the IRA would help bring down inflation within the first couple years after enactment. Yet, beyond the near term, high inflation was not expected to persist.[14]

Front-Loaded Costs. The Penn Wharton Budget Model (PWBM) estimated that the IRA adds to the deficit in each year through 2026, and therefore it is expected the IRA would produce some *upward* pressure on prices in 2023 and 2024.[15] The PWBM estimated the act would then reduce annual inflation by around 0.1 percentage points in approximately five years (2027), but have no measurable impact on inflation after 2028. Similarly, the CBO projected that the IRA would add to the deficit through 2026 and estimated that the IRA would have almost zero effect on inflation.[16]

Phantom Reductions. Even these analyses were too generous about the IRA's impact on the deficit and inflation. CBO scorekeepers credited the legislation with $122 billion of Medicare savings over 10 years for not implementing a prescription drug–rebate rule that already was unlikely to ever be implemented (not to mention doubts about whether implementation of the drug-rebate rule would raise or lower the deficit).[17] Removing these phantom savings would change the CBO's 10-year deficit-reduction score to a deficit *increase* of $64 billion.[18]

A narrow surplus would still be possible, at least in theory, if expanded IRS audits (discussed later in the Claim No. 2 section) from new enforcement funding bring in enough revenue. Of course, diverting more labor and other resources to deal with audits, tax disputes, and higher IRS collections will leave fewer resources to go into the production of the goods and services people need, hardly a recipe for slowing the rise of prices.

There are strong reasons to expect that the IRA will ultimately add to the 10-year deficit:

- Budget gimmicks in the new law that assume arbitrary sunsets of spending programs that, history shows, Congress is unlikely to actually allow to sunset;

- Major apparent cost overruns stemming from the law's green subsidies exacerbated by liberal implementation and regulatory and industry maneuvering; and

- Failure to account for reduced tax revenues resulting from effects that will suppress economic growth.

More Budget Gimmicks. One major budget gimmick in the law is a three-year extension of the supposedly temporary COVID-19-era expansion of Obamacare tax credits.[19] While the new taxes in the law are scored over a 10-year budget period, the legislation only included a three-year extension of these tax subsidies. Congress avoided counting $146.5 billion of additional costs that will ultimately arise unless a *future* Congress allows these expanded credits to expire after 2025.[20] In the past, Congress has routinely passed "tax extender" packages to repeatedly extend established tax breaks that are set to expire. Often these packages bundle all or many expiring tax breaks together to ensure bipartisan support.

Green Tax Credits That Cost a Lot of Green. The cost of the green tax credits in the IRA now appears to be soaring far beyond what was originally anticipated. The CBO originally projected that the green tax credits (not including other climate provisions such as deductions, grants, and loans) in the IRA would cost about $234 billion between 2023 and 2031.[21]

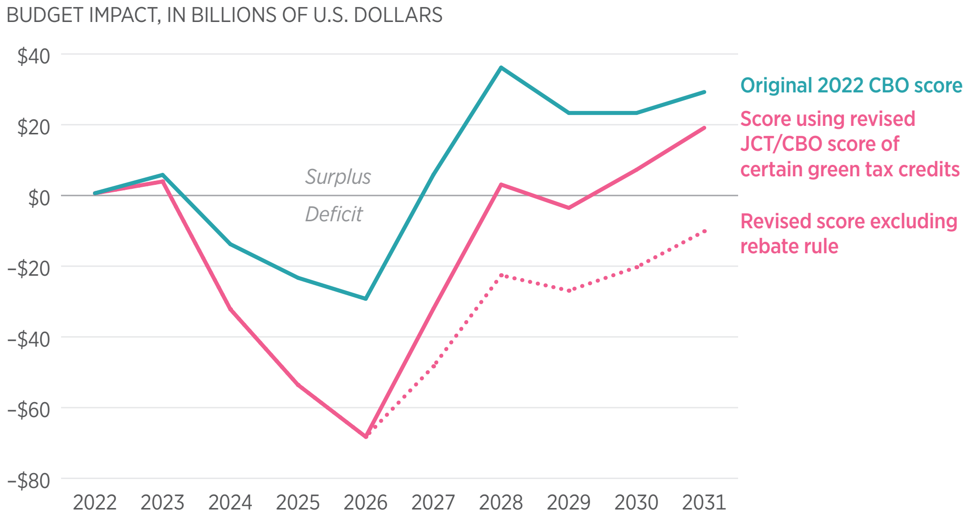
Estimates of the cost of the green tax credits has since ballooned. Citing analysis by the Joint Committee on Taxation (JCT), the CBO now (as of April 2023) says that a repeal of the credits would reduce the deficit by about $570 billion over 10 years.[22] The actual number is most likely much higher, because the updated JCT score only provided revised estimates for some provisions and not others.

Notably, the JCT's new score did not include updated estimates of the cost of the clean-vehicle credits, even though it is widely expected that the clean-vehicle tax credit costs will be much higher than originally anticipated. (See discussion in the Maneuvering for More section below.) A comprehensive update to the estimated cost of the tax credits would likely show an even larger increase in cost. Goldman Sachs has forecast that the IRA "will provide an estimated $1.2 trillion of [green energy–related] incentives by 2032," though it should be noted that this estimate is not strictly comparable to the original CBO forecast.[23]

Unlike appropriated funds, there is no hard cap on how much tax credits could cost.[24] The fact that businesses generally can only use tax credits to reduce tax liability to zero (but not below) has limited previous green tax credits. However, the IRA changed that dynamic by introducing transferable tax credits. Markets are forming to help companies sell their tax breaks to more profitable companies at a slight discount. This will allow the companies to continue benefiting from the tax credits as long as *other*

CHART 1

Budget Impact of the "Inflation Reduction Act"



SOURCES: Congressional Budget Office, "Estimated Budgetary Effects of Public Law 117–169, to Provide for Reconciliation Pursuant to Title II of S. Con. Res. 14," https://www.cbo.gov/publication/58455 (accessed June 5, 2023), and U.S. Congress, Joint Committee on Taxation, "Estimated Revenue Effects of Division A, Title III of H.R. 2811, The Limit, Save, Grow Act of 2023," April 26, 2023, https://www.jct.gov/publications/2023/jcx-7-23/ (accessed June 5, 2023).

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companies have tax liability to offset. This will contribute to the rising cost of the green tax credits, adding further to the law's overall deficits.[25]

A Liberal Definition of SUV. More small crossover vehicles will qualify for the electric vehicles (EV) tax credits because of Treasury's liberal interpretation of what qualifies as a sport utility vehicle (SUV). Under the IRA, electric vans/SUVs/pickup trucks with a manufacturer suggested retail price of $80,000 or less can qualify for the credit, while the maximum price for other EVs (cars) is $55,000.[26] The IRA states that the Secretary of the Treasury should determine which vehicles qualify as vans/SUVs/pickup trucks "using criteria similar to that employed by the Environmental Protection Agency (EPA) and the Department of Energy to determine size and class of vehicles."[27]

Initially, guidance indicated that Treasury would rely on the EPA definition of SUV in 40 Code of Federal Regulations (CFR) § 600.002 to determine what vehicles do and do not qualify as SUVs.[28] The EPA definition of SUV clearly states that an SUV must be a light truck, a term defined in 49 CFR § 523 and 49 CFR § 523.5.

However, after industry pressure, the Treasury Department indicated it would instead classify vehicles as SUVs if they are classified as a small SUV or standard SUV under 40 CFR § 600.315–08(a)(2)(v) and (vi).[29] These rules, used for consumer fuel-economy labeling purposes, do not provide a definition or objective criteria for determining what is an SUV—rather they rely on the judgment of the EPA administrator.[30] This change will allow additional EVs in the $55,000 to $80,000 price range to qualify for the EV credits, including the Cadillac Lyriq, the Ford Mustang Mach-E, and more expensive versions of Tesla's Model Y.[31] All such expansions of the tax credits will, of course, further increase the cost of the IRA.

Maneuvering for More. The White House and Treasury Department have also been engaged in maneuvering to expand the availability of some of the IRA's green credits beyond what is provided for in the legislative text. The law states that to qualify for the full $7,500 value of the EV tax credits, vehicles must be manufactured in North America, and at least 40 percent (rising to 80 percent by 2026) of the critical minerals used in batteries must be sourced in the U.S. or countries with free trade agreements with the U.S.[32]

The legislation was scored based on these restrictive requirements. However, after receiving criticism (and, in some cases, threats of retaliation) from the European Union, Japan, South Korea, and the U.K., the Biden Administration has pushed for changes to "fundamentally make it easier for European countries to participate."[33] In December 2022, Treasury announced it would delay issuance of guidance on the battery component rules, so the critical-mineral country requirements did not take effect until the end of March 2023.[34] This opened the door for purchasers of non-qualifying EVs to claim the credit if they bought the vehicles before Treasury issued the new proposed guidance on March 31, 2023. Treasury also suggested in a white paper that it would apply a broad definition of what constitutes a free trade agreement in an apparent effort to make the credits more readily available.[35]

Industry analysts have projected that the advanced manufacturing production credits, a $35 per kilowatt-hour tax credit for qualifying U.S.-produced batteries, will cost much more than the CBO's $30.6 billion 10-year estimate. Benchmark Mineral Intelligence has estimated the cost could soar as high as $136 billion, more than quadruple the CBO's estimate.[36]

Car companies are also maneuvering to take advantage of the credits, including higher-priced EV makers whose 2022 prices would have exceeded the maximum price threshold to qualify for the credits. Tesla, which accounted for 65 percent of U.S. EV sales in 2022, announced in January 2023 that it was slashing the prices of its most popular vehicle models.[37]

By dropping the base price of the Model Y from $65,990 to below the tax credit's maximum price threshold of $55,000, Tesla's move helped to ensure that buyers of America's 2022 top-selling EV would be able to qualify for the generous $7,500 tax credit.[38]

Unsound Investments Drag Down Economy and Tax Revenues. Finally, the legislation will likely contribute to deficits by driving capital investments into less profitable ventures like the green-energy companies mentioned above. Companies that are propped up by large government subsidies do not become more efficient or globally competitive in the long run. Instead, lacking vigorous market competition and the self-correction that it forces, subsidized companies only grow more reliant on continuing state assistance.[39]

Furthermore, every dollar of capital that investors funnel into green-energy companies because of this law is a dollar that is diverted from elsewhere in the economy where it could have generated a higher expected return on investment (before taxes and subsidies), higher incomes, and higher tax revenue. New taxes on stock repurchases, corporations, and natural gas and petroleum production will also act as a drag on the economy.[40] The CBO's scoring does not account for reduced revenues associated with such macroeconomic effects.[41]

If the IRA does drive capital away from high-return investments, it may cause higher-than-expected increases in interest payments and debt-servicing costs and slower growth in typically high-growth industries that rely heavily on new capital from financial markets.

Claim No. 2: The New IRS Funding Will Pay for Itself by Cracking Down on Big Tax Cheats Without Impacting Small Taxpayers.

One of the more controversial pieces of the legislation is approximately $71 billion of supplemental funding provided to the IRS for enforcement and operations support, $45.6 billion of which is specifically dedicated to enforcement activities such as audits, collections, legal and litigation actions, criminal investigations, asset monitoring, and compliance activities.[42] Proponents of the law claim the new enforcement funding will pay for itself several times over by increasing compliance among the wealthy and corporations, without subjecting taxpayers earning less than $400,000 to more audits.[43] Treasury Secretary Janet Yellen did send a letter to the IRS commissioner saying that additional funding and resources shall not be used to increase audit levels on small businesses or households earning less than $400,000 relative to historical levels.

However, IRS Commissioner Daniel Werfel gave congressional testimony suggesting that this commitment has an expiration date, stating for example that "[o]ur focus will be on other high-dollar areas *for quite some time*." When pressed to give a specific time frame, Werfel said, "I would say in the 3-to-4-year time frame I will have enough information in the capacity-building that we're doing for high-income filers that I'll be able to say what's next."[44]

The Treasury Department's own projections of new collections stemming from more audits are unrealistically high, especially if the IRS and Treasury are to stick to the supposed self-imposed constraint against increasing audits on taxpayers making less than $400,000. A 2021 Treasury report estimated that the additional IRA funding would allow the agency to increase collections by $316 billion during the course of a decade, including $83 billion in the 10th year.[45] These impossibly high projections are inconsistent with the idea that the agency intends to leave the status quo in place for the 98 percent of taxpayers that report less than $400,000 of income.[46]

Estimating the Tax Gap. The amount of new revenues raised by expanding IRS enforcement partially depends on how compliant taxpayers already are. IRS claims of a massive tax gap between the amount of taxes legally owed by U.S. taxpayers compared to what they pay are exaggerated.[47] The tax gap for the very wealthy and corporations is especially exaggerated.

The IRS periodically performs rigorous audits on a statistically representative sample (known as the National Reporting Program (NRP) sample) of the population.[48] The results of these audits are used to gauge tax noncompliance. Extrapolating from those audits, the agency most recently projected an overall annual net tax gap between 2014 and 2016 of $428 billion.[49] The methodology used to arrive at this estimate of the tax gap is dubious and certainly should not be construed as the amount of revenues the IRS could raise with sufficient funding.

The IRS methodology skews the data in ways that exaggerate the size of the tax gap. To name just one problem, the IRS applies a detection-controlled estimation (DCE) adjustment. The idea behind the DCE adjustment is that when different auditors examining similar types of returns recommend different levels of adjustments on the similar returns, it is assumed to be because less skilled or less experienced examiners have failed to detect all the issues present in the returns they examined.[50] Therefore the IRS adjusts upwards the estimated underreported income in returns examined by auditors with lower adjustment rates to match the examiners with the highest adjustment rates.[51]

Using this DCE adjustment methodology, the IRS roughly *triples* its estimate of underreported income contributing to the tax gap.[52]

Audits from Hell. There are strong reasons to doubt the validity of using DCE adjustments to estimate the tax gap, let alone to estimate how much additional revenue the IRS could realistically raise with expanded audits. Notably, the statistically representative audits used in the NRP sample are referred to as "audits from hell" because they are so stringent.[53] By applying the DCE adjustments, the IRS is tacitly suggesting that even these notoriously stringent audits are too tame and ought to result in *three times* more additional collections.

As stated by the IRS, "Not all underreported income is detected by every audit, even audits of the scope and quality conducted under the NRP."[54] Tax laws and regulations are unimaginably complex, and accountants, lawyers, taxpayers, and the IRS frequently disagree about the proper interpretation of rules to a given case. Tax courts often side with taxpayers and against the IRS in disputes. Yet, if the tax gap is accurate, only the most aggressive IRS auditors are right, and everyone else—including other IRS auditors—is wrong.

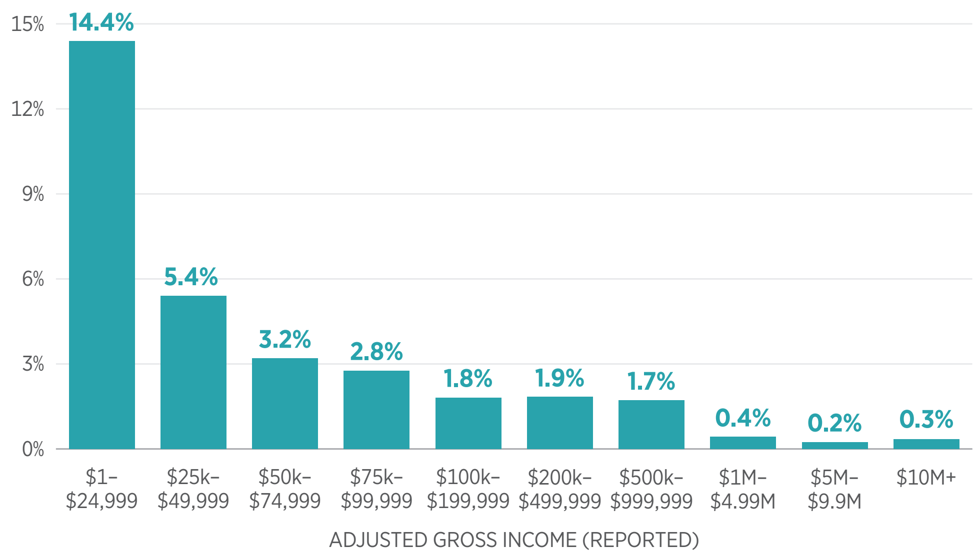
The estimated tax gap *excluding the DCE adjustment* should be viewed as an upper-bound estimate of how much additional collections are theoretically possible assuming almost unlimited new IRS enforcement funding. Removing DCE adjustments suggests no more than about $140 billion of annual tax collections might be possible if every single American was subjected to an NRP-style audit from hell.[55] (This ignores the dramatic reduction in economic output and tax revenues that would result if every American was bogged down by perennial audits.)

An Impossible Task. Only about one-fifth or less of the $140 billion of theoretically possible additional tax collections from expanded IRS enforcement is from taxpayers whose true adjusted gross income is in the top 2 percent (roughly corresponding to $400,000 of income).[56] The one-fifth figure, notably, is based on data from a study that was cited in a Treasury Department post that ostensibly argued that there is a high level of tax noncompliance among high-income taxpayers.[57]

Despite obfuscation by Treasury, the study plainly states, "compliance rates at the top of the income distribution are significantly higher than at other points."[58] Chart 2 shows that taxpayers with higher reported adjusted gross income tend to underreport a significantly *smaller* percentage of their income. The steep decline in adjustments with income partially reflects higher rates of compliance by high-income taxpayers. Part of the challenge for the IRS, though, is that the act of underreporting one's income tends to

CHART 2

Audit Adjustments as a Percentage of Pre-Audit Income



NOTES: Average audit adjustments by income group are based on audits of statistically representative samples of taxpayers in the IRS National Research Program.
SOURCE: Jason DeBacker et al.,Tax Notes, "Tax Noncompliance and Measures of Income Inequality," February 17, 2020, Table A2, https://www.taxnotes.com/tax-notes-federal/compliance/tax-noncompliance-and-measures-income-inequality/20 20/02/17/2c3y5 (accessed January 26, 2023).

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push people into lower categories of reported income, including below the $400,000 threshold.

Expanding audits to all corporations and estates (which already face high probabilities of audits) is also unlikely to add much to collections. The IRS estimates that only 9 percent of the tax gap relates to corporate income and estate tax income.[59]

Less Qualified Auditors. Previous estimates from the IRS suggest that with the additional funding it will increase its full-time equivalent staffing by 87,000—more than doubling the agency's size in less than a decade. There will also be an increase in demand for accountants, auditors, enrolled agents, and tax lawyers to work in the private sector to deal with additional IRS enforcement activity. This burst of demand for auditors and tax professionals comes as employers are struggling to find qualified workers to fill open positions. (Incidentally, this will drive up labor costs in other parts of the economy and put upward pressure on inflation.)

Since few people grow up aspiring to work at the IRS, the agency will face stiff competition to attract enough qualified new employees to fill all the new open positions.[60] In a recent webinar on the Future of IRS Funding, former IRS Commissioner Charles Rettig spoke about the hiring challenge, noting that the IRS needed to offer a more generous slate of benefits to new employees, mentioning tuition reimbursement, student loan repayments, elder care, and continued remote work. Rettig said of the hiring challenge, "It's going to be a tussle. The first wave of hirings would be easier than the second, third or fourth wave years down the road."[61]

Indeed, with each successive hire, the IRS should expect to bring in new employees that, on average, are less qualified and less predisposed to IRS work. Newly hired auditors will almost certainly tend to be less effective at identifying unpaid taxes than existing, more experienced IRS agents, further diminishing the amount of new revenues that can be reasonably anticipated from the new funding.

Claim No. 3: The Law Will Stop Corporatist Tax Breaks.

The act's supporters claim that the IRA will reduce the corporatism that allowed 55 of America's largest companies to pay no federal taxes in 2020.[62] The reality is that the new law showers massive tax subsidies onto the very corporations that already benefit most from preferential subsidies and tax advantages.

Taxable Losses. There are valid reasons why some profitable companies may not pay federal income taxes in a specific year. Taxable losses, known as net operating losses (NOLs), can be carried forward and used to offset taxable income in future years. Many companies accumulate NOLs in their early years before becoming profitable as they mature. Other companies operate in industries that are highly cyclical, with large losses in bad economic years giving way to profits in boom years. Such companies may avoid federal income taxes until their NOLs are spent. Allowing companies to carry forward NOLs is, in fact, correct policy. Requiring tax payments from companies that have yet to offset past losses would be neither fair nor economically sound.[63]

Flash in the Pan? The same Institute on Taxation and Economic Policy (ITEP) that reports that 55 companies did not pay 2020 federal taxes on their profits claims that the occurrence of companies paying zero taxes is "not a flash in the pan," noting that 26 profitable companies paid no net federal income taxes during a three-year period from 2018–2020. However, a closer look at these 26 companies shows why the IRA will only make it more common for companies to consistently avoid paying income taxes.

Extending the period of analysis by one additional year to consider the period from 2018–2021 whittles the 26 companies with no net current federal income tax liability down to 13.[64] The 26 companies cited in the ITEP report paid a total of more than $2.2 billion in federal income taxes in 2021 alone. They also paid $700 million in state and local income taxes and more than $2.4 billion in foreign income taxes in 2021. When factoring in state, local, and foreign income taxes there were more companies on the ITEP list that paid at least a 14.0 percent combined income tax rate (not counting taxes at the investor level) in the four-year period of 2018–2021 than paid less than 2.0 percent.

Green Tax Credits. Although the premise of companies not paying their share of taxes is overstated, there is some truth to the claim that some profitable companies can avoid paying corporate income taxes for many years at a time. The profitable companies that perennially avoid corporate income taxes typically use generous tax credits to offset tax liabilities. Specifically, electric utility companies comprise most of the untaxed or undertaxed companies in the Standard & Poor (S&P) 500 or Fortune 500 companies. Seven of the eight companies shown in Table 1 that paid less than a 2.0 percent combined income tax rate are in the utilities, gas, and electric sector, which makes up less than 6 percent of the companies in the S&P 500.[65]

The utility and energy companies that avoid corporate income taxes reduce their taxes largely by using the Renewable Energy Production Tax Credit (PTC) and the Energy Investment Tax Credit (ITC), two large energy-related tax credits that pre-existed the IRA. The PTC and ITC are both intended to expand renewable energy. The PTC provides credits per kilowatt hour of energy produced using qualifying technologies including wind, biomass, geothermal, solar, irrigation power, and qualified hydropower.[66] The ITC provides credits for qualifying expenditures, including for solar- and geothermal-energy properties, fuel-cell power plants, geothermal heat pumps, small wind turbines, offshore wind, and waste-energy recovery.[67]

The PTC and ITC allowed companies to reduce their tax liabilities by $11.5 billion in 2022.[68] Other energy-related tax credits offset another $5.5 billion of taxes in 2022.[69] Although companies are not required to provide full details about their use of tax credits on their annual reports, some of the information reported on the undertaxed utility companies' 2021 filings show the importance of PTCs, ITCs, and other energy-related tax credits in allowing them to avoid federal income taxes.

TABLE 1

Corporate Income Taxes Paid, 2018–2021, by Companies Identified by ITEP as Paying Zero Federal Income Taxes from 2018–2020

Utilities, gas, and electric

		IN MILLIONS OF DOLLARS	
Company	**Effective Combined Corporate Tax Rate**	**Federal Income Taxes**	**Federal, State & Local, and Foreign Income Taxes**
Cabot Oil & Gas	50.2%	$8	$374
Nike	24.3%	$1,460	$4,530
Salesforce.com	23.0%	$2	$1,330
Howmet Aerospace	18.6%	–$11	$180
Ball	16.0%	–$24	$469
Sanmina-SCI	14.2%	$1	$121
Archer Daniels Midland	14.2%	$373	$1,254
Mohawk Industries	14.1%	$102	$516
Westlake Chemical	14.0%	$404	$688
PPL	9.3%	$393	$718
Penske Automotive Group	8.3%	$46	$293
UGI	6.9%	–$83	$271
Textron	6.7%	–$5	$234
Kinder Morgan	6.3%	–$44	$541
FedEx	6.3%	–$678	$840
Advanced Micro Devices	4.4%	$111	$251
Dish Network	2.6%	$113	$262
American Electric Power	1.4%	$45	$122
FirstEnergy	0.7%	–$44	$39
Xcel Energy	–0.6%	–$48	–$36
CMS Energy	–3.4%	–$134	–$107
Williams	–4.1%	–$154	–$153
Evergy	–4.3%	–$118	–$99
DTE Energy	–5.8%	–$453	–$439
Duke Energy	–6.5%	–$899	–$766

NOTES: Effective combined tax rate is the total current federal, state and local, and foreign income tax expenses divided by companies' worldwide income before income taxes. One company in ITEP's list was a partnership during the period and is excluded from the table above because partnership tax liabilities pass through to the partners instead of being paid at the company level.
SOURCE: Individual companies' annual 10-K reports filed with the U.S. Securities and Exchange Commission.

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- American Electric Power (AEP) reported that at the end of 2021 it had more than $470 million of federal tax credit carryforwards, which will allow it to offset future tax liabilities.[70] The only federal tax credits mentioned on its annual report were ITCs and PTCs.[71]

- CMS Energy used PTCs to reduce its 2021 U.S. federal tax liability by $40 million. The company also reported $264 million of general business credit carryforwards (a substantial portion of which are likely PTCs). The only other tax credit identified as decreasing income tax liability in 2021 was the Research and Development tax credit, which reduced CMS Energy's tax liability by $3 million in 2021.[72]

- DTE Energy used PTCs to reduce its 2021 U.S. federal tax liability by approximately $208 million and used ITCs to reduce its tax liability by about $6 million.[73] The only federal tax credits mentioned on its annual report are ITCs and PTCs.[74]

- Duke Energy used PTCs to reduce its 2021 U.S. federal income tax liability by $100 million. Duke Energy also used more than $70 million of other unspecified tax credits.[75] Other than PTCs, the only other tax credits mentioned in the annual report are ITCs and foreign tax credits. The company reported over $2.3 billion of tax credit carryforwards, not including foreign tax credits.

- Evergy Inc. and its subsidiaries had a combined $740 million of tax credit carryforwards as of December 31, 2021. According to the company, "The carryforwards for Evergy, Evergy Kansas Central and Evergy Metro relate primarily to wind production tax credits and advanced coal investment tax credits and expire in the years 2022 to 2041."[76]

- FirstEnergy claimed $34 million of federal tax credits in 2021. The only type of tax credit mentioned on its annual report were ITCs.[77]

- Xcel Energy used wind PTCs to reduce its 2021 federal tax liability by more than $23 million. The company also reported that at the end of 2021 it had more than $1.17 billion of federal tax credit carryforwards.[78]

Utility companies have long benefited from generous tax treatment of their renewable energy investments and production.[79] In a separate 2017 analysis, ITEP identified 18 companies that did not pay federal corporate income taxes in the 2008–2015 period, a period predating the major tax reform of 2017. Fifteen of the 18 companies identified in that study are utility companies.[80] ITEP found that as an industry utilities, gas, and electric companies paid an effective federal tax rate of 3.1 percent in that period. According to ITEP's analysis, all other industries paid at least an 11.4 percent effective federal tax rate.

Expanding Green Tax Credits. The IRA dramatically expanded the availability of green-energy business tax credits beginning in 2023, which will allow more corporations to qualify for the credits and to avoid paying federal income taxes. The IRA extended and made some modifications to the ITC and PTC and other credits, such as credits for biodiesel, other alternative fuels, and advanced energy projects. The IRA also introduced (or resurrected) many additional energy-related tax credits, including:[81]

- A carbon oxide sequestration credit,
- A zero-emission nuclear power production credit,
- A sustainable aviation fuel credit,
- A credit for clean hydrogen production,
- A credit for qualified commercial clean vehicles,
- An alternative fuel refueling property credit,
- An advanced manufacturing production credit,
- A clean electricity production credit,
- A clean electricity investment credit, and
- A clean fuel production credit.

Each of the seven utilities companies with no net federal income tax liability between 2018 and 2021 have indicated that they plan to increase their spending on nonconventional energy during the course of the next decade, spurred by the growing availability of federal energy subsidies. By 2030, the Joint Committee on Taxation estimates expansions of energy credits will reduce qualifying companies' tax liability by an *additional* $36 billion per year, at least tripling companies' energy-related tax credits compared to 2022 levels.[82]

A Minimum Tax for Thee But Not for Me. The new corporate minimum tax implemented under the IRA allows companies to use general business credits (including the energy credits described above) to offset 75 percent of their minimum tax liability. The IRA will effectively lead some companies to have negative corporate tax liability because the IRA provides for "credit monetization" through the sale of tax credits related to clean vehicles, renewable energy generation, carbon sequestration, clean fuel, and energy manufacturing tax credits.[83] Therefore, by doubling down on the biggest business subsidies in the tax code, the IRA will almost certainly exacerbate the problem the IRA supposedly seeks to address.

Claim No. 4: The IRA Will Significantly Reduce Greenhouse Gas Emissions and Slow Climate Change.

Supporters have touted the IRA as the most significant climate legislation ever passed.[84] Given the cost of the green subsidies, one would hope that the law would have a significant positive effect on the environment. However, it almost certainly will not meaningfully reduce global greenhouse gas (GHG) emissions or global temperatures. Before the law's passage, U.S. emissions had already been falling for decades, driven largely by market forces including the increased penetration of natural gas allowed by improved extraction technology.[85] Meanwhile, developing nations have accounted for a growing share of global emissions: China accounted for about one-quarter of global emissions in 2021.[86] The U.S. accounted for about 12 percent, down from almost 17 percent in 1990.[87]

Even assuming the worst about global warming, the U.S. could eliminate GHG emissions today and it would have almost no impact on global temperatures by the end of the century, reducing global temperatures by less than 0.2 degrees Celsius by 2100.[88] Of course, the IRA's green tax credit provisions will come nowhere near eliminating U.S. emissions. A project led by Princeton University's Zero-carbon Energy Systems Research and Optimization Laboratory—a research lab that seeks to "accelerate rapid, affordable, and effective transitions to net-zero carbon energy systems"—estimates that the IRA will reduce U.S. emissions by about 6.3 billion metric tons of CO_2-equivalent during the course of a decade.[89]

Taken at face value, that would amount to approximately a 13 percent reduction compared to the current path of U.S. emissions. However, many of the tax credits and other green subsidies will then expire or phase out after about a decade unless further costly legislation is passed. Even if the 13 percent decline in U.S. emissions persisted until 2100 (despite the tax subsidies expiring), the IRA would likely reduce global temperatures by less than 0.03 degrees.[90] In the likely event that the effect on GHG emissions fades after the expiration of the subsidies (a period lasting nearly 70 years from about 2033 to 2100), the IRA would have no meaningful impact on global temperatures this century.

More than two-thirds of GHG emissions come from developing countries, and that percentage is rising—for good reason. While many Western nations have enjoyed relatively uninhibited access to energy for more than a century, people in developing countries lack reliable and affordable—or in some cases, any—access to heat, power, and transportation energy.[91] The hundreds of billions of dollars the IRA gives to green-energy companies in the U.S. will do nothing to address the *88 percent* of emissions coming from the rest of the world. Indeed, protectionist measures in the green-energy provisions have caused outrage among some of America's European allies.[92]

In addition to protectionist trade measures, the IRA imposes other hoops for companies to jump through to qualify for the maximum amount of the various green subsidies, including prevailing-wage requirements, apprenticeship requirements, and bonuses for setting up shop in certain communities. These measures only make companies less efficient and more dependent on continued subsidization and reduce the likelihood that they develop a long-term, commercially viable business model.[93]

The Inflation Reduction Act: The Wrong Approach

It is highly unlikely that the IRA will accomplish its key objectives. Its supporters claim it will reduce the deficit, close the tax gap, level the playing field so that all businesses pay their fair share of taxes, and meaningfully address climate change. All these claims are dubious, if not demonstrably false. If Congress wishes to address these concerns, there are much better ways it could do so. The following sections outline an alternative approach to addressing each of these concerns.

A Better Approach to Cutting the Deficit and Inflation

Substantive deficit reduction cannot occur without reducing federal spending, which in fiscal years 2020, 2021, and 2022 consumed an average of almost 29 percent of gross domestic product (GDP).[94] That is higher than any other year on record outside of World War II, far higher than the previous high of 24.3 percent reached in 2009.[95] Unfortunately, the new taxes, budget gimmicks, and expanded IRS audits in the IRA do not address overspending, the root cause of America's soaring deficits. Tax revenues were already near historic highs before the IRA and cannot rise higher without inflicting serious damage to the U.S. economy and harm to American households.[96]

To control the deficit and inflation, Congress must:

Repeal the Inflation Reduction Act. The IRA will not reduce inflation. It will only hamper businesses with new regulations and new taxes, increase deficits, and drive up borrowing costs for individuals and sound businesses by redirecting capital toward the pet projects of politicians and lobbyists. Congress should reject this top-down federal micromanagement of the U.S. economy and should repeal the IRA.

Make the Budget Sustainable. The CBO projects that Social Security, Medicare, Medicaid, and other mandatory health care programs will account for more than half of non-interest federal outlays in 2023 and will rise to about 65 percent by 2050 if spending continues unabated.[97] Yet even with the growing unsustainability of mandatory entitlement spending, lawmakers allowed discretionary spending to grow by 46 percent between 2017 and 2022, including a 66 percent increase in non-defense discretionary spending.[98]

To avoid a future fiscal crisis, Congress must pass meaningful reforms to reduce both mandatory and discretionary spending. If the Social Security and Medicare trust funds are exhausted—as the Social Security and Medicare Trustees expect will happen by 2035—mandatory 23 percent across-the-board cuts to current retirees' benefits will go into effect.[99] To prevent this, the shortfalls in the entitlement trust funds should be addressed with measures such as increasing the retirement age for future retirees, more accurate inflation indexing, and gradual reductions in benefits of upper-income earners (for future retirees).[100]

Implement Pro-Growth Tax Policies. Americans' ability to pay taxes and thus make interest payments on the soaring national debt depends on the size of the American economy. Overtaxing business, investing, and entrepreneurship stifles growth: It is not possible to have good jobs without job creators. A truly pro-growth tax code would not tax capital that is reinvested back into the economy until such time as that capital (or the profit it creates) is taken out and made available for consumption.

Lawmakers should eliminate or reduce the most anti-investment features of the tax system. For example, they could end the 3.8 percent

Obamacare surtax on investment income, index capital gains for inflation, reduce or eliminate the death tax, allow expensing of research and development and capital expenditures (discussed in the A Better Approach to Addressing Environmental Concerns section below), or establish universal savings accounts to allow families to invest after-tax wages without facing an extra layer of taxation on investment earnings.[101]

Meanwhile, the tax code should not subsidize less productive activities of companies in politically favored industries. Such subsidies lead to misallocated resources, and they sap the economy. Most business tax credits are unnecessary and can be eliminated to offset any lost short-run losses in tax revenues from pro-growth tax cuts. As economic growth builds upon itself, pro-growth tax reforms would generate more tax revenue and improve the nation's fiscal situation over the long run.

Eliminate Harmful Regulations. Misguided federal regulations are an impediment to businesses and workers and lead to less economic output and lower tax revenues. Regulations drive up the cost of doing business, which ultimately gets passed down to consumers in the form of stagnant products and higher prices. Nowhere is that truer than with respect to energy, one of the biggest drivers of rising prices in recent years. Misguided policies like forcing companies to comply with the Renewable Fuel Standard, blocking the Keystone XL Pipeline, and excessive restrictions on oil and gas exploration and production on federal lands and waters have all driven rising energy costs. Congress and the White House should deregulate and unleash American energy and the broader economy.[102]

A Better Approach to Closing the Tax Gap

The notion of a "tax gap" suggests that Americans systematically underpay their taxes compared to their true tax liability. However, an enormous level of subjectivity in the federal tax code frequently leads to disagreements among accountants, the IRS, and tax courts about how much tax liability a given taxpayer has under the law. The tax gap is a fuzzy concept and stems mostly from a gap in people's interpretation or understanding of ambiguous tax laws and regulations. After cobbling together a 6,979-page tax code that, in turn, led the IRS to promulgate 17,507 additional pages of regulations, Congress deserves most of the blame for the lack of transparency in the tax system and any understanding gap.[103]

To close this "gap," Congress should:

Simplify the Tax Code. Removing onerous tax laws and rules and paring back special tax breaks would close the understanding gap, make it easier for taxpayers to comply with tax obligations, and improve IRS tax administration. A simpler tax code is fairer and would limit opportunities for sophisticated taxpayers and accountants to use their knowledge of the tax system to legally reduce their taxes relative to otherwise similar taxpayers.[104] Congress should start simplifying the tax code by repealing the tax provisions in the IRA that make the tax code more complicated to comply with and administer, including the bevy of green tax credits and the new book-minimum tax based on financial statement income.

Prioritize Taxpayer Service and Systems Modernization at the IRS. Especially with a woefully complex tax system, it is imperative that taxpayers have the resources and information necessary to understand what taxes they owe. In FY 2022, an abysmal 13 percent of taxpayer calls to the IRS reached a customer service representative.[105] Yet, compared to $45.6 billion of supplemental funding for IRS enforcement in the IRA, Congress only appropriated $3.2 billion for taxpayer services and $4.7 billion for business systems modernization.[106]

Congress's funding of the IRS should focus more on taxpayer services and business systems.[107] Future appropriations should ensure that the IRS does not expand enforcement and audits on Americans at the same time it fails to provide basic services like answering phone calls from taxpayers attempting to comply with convoluted tax rules.

Reduce Improper Payments. In FY 2021, the IRS made improper payments amounting to an estimated $19.0 billion for the earned income tax credit (EITC) and $5.2 billion for refundable child tax credits.[108] These are almost entirely overpayments to individuals with no net income tax liability. EITC improper payments are usually related to residency misreporting—in which individuals claim credits for children that do not live with them for all or most of the year—and income misreporting. The IRS should ensure that before checks are sent, individuals' reported income is verified and that no other tax returns claim credits for the same children. The IRS should also apply minimal residency checks using secure federal databases, such as matching claimants' addresses against children's school addresses from school lunch program data.[109]

A Better Approach to Removing Unfair Advantages for Businesses

Many Americans correctly perceive that certain special interest groups have greater access to the political process and wield too much power in Washington. The root of the problem is too much centralized power in the federal government. The IRA *increases* federal power to the advantage of select industries with its new regulations, spending, and taxes.

To remove unfair advantages for select businesses, Congress (and, when applicable, executive branch agencies) should:

Eliminate Special Business Tax Breaks. Lawmakers should strive for a neutral tax system that follows the general principle that each dollar of capital taken out of the economy (consumed), whether earned from corporate stock, real estate investment, or from a closely held business, should face the same total level of taxation. Absent truly exceptional circumstances, the tax code should not single out specific industries for special tax advantages. Most business tax credits should be repealed. In addition, Congress should close corporate deductions for non-business expenses like government lobbying and ideologically-driven corporate donations to political causes.

Reduce Industry and Labor Regulations. Taxes are just one avenue by which certain businesses can gain an advantage over competitors. Many regulations explicitly or implicitly protect favored businesses, industries, regions, or labor unions by handicapping competition. Congress frequently passes legislation that grants overly broad authority to the discretion of executive branch agencies, opening the door to many burdensome regulations.[110]

Under the Department of Labor's regulations in the Davis–Bacon Act, federal contractors on public works projects must pay "prevailing" wages using statistically non-representative samples of local wages, adding to the cost of public infrastructure and disadvantaging small firms and non-unionized companies.[111] The Jones Act requires cargo transported between U.S. ports to be carried on ships with American crews.[112] Similarly, the IRA imposes "prevailing wage" and domestic production requirements. To foster a healthy, competitive business environment, Congress should prioritize repealing harmful laws and regulations like these that grant special favors and raise costs.

Stop the Proliferation of "Stakeholder" Capitalism. Under stakeholder capitalism, environmental groups and other activists can exert control over businesses by direct influence of corporate boards, instead of companies focusing on improving the lives of their customers and communities while providing the means for their shareholders and workers to support their families.[113] Under the stakeholder capitalism model, corporate boards are pushed to make investments and other business decisions that put them in the good graces of environmental, social, and governance (ESG) ratings firms.[114] The Securities and Exchange Commission (SEC) is accommodating the ESG movement by pushing expensive mandates for climate-change disclosures from public companies, an effort abetted by the Department of Labor's recent regulation about fiduciary investing.

All of this redounds to the benefit of many of the same companies that exerted their influence to receive hundreds of billions of dollars in preferential green subsidies in the IRA. They can effectively lobby for favorable changes to subjective ESG rules or push for regulations that hamstring the competition. Smaller companies have fewer resources to absorb the massive burden of complex ESG disclosure requirements and are most likely to be harmed.[115]

Congress should pass legislation and conduct oversight to ensure that the SEC focuses on its key role of protecting investors from fraud and misrepresentation and that the Labor Department focuses on returns, not social activism. SEC disclosure requirements should be limited to information pertinent to the financial interests of shareholders, and fiduciaries of retirement plans should be required to consider only the best financial interests of their retirees. When voting as proxies, major institutional investment managers who manage Americans' retirement accounts should be required to vote based on the financial considerations of their clients, not ESG considerations that managers—not retirees—favor.[116]

A Better Approach to Addressing Environmental Concerns

According to the EPA, the U.S. has 20 percent lower GHG emissions today than it did in 2005, even though the U.S. population and economy have grown significantly in that period.[117] Human innovation and technological advancement naturally lead societies to adopt cleaner and more energy efficient technologies over time. If the U.S. economy had stood still, American industry and energy technology would also have stopped advancing and the U.S. would almost certainly pollute and emit more carbon more than it does today.

Misguided laws and regulations are frequently counterproductive to the goals of protecting human health and safety, environmental protection, and reducing GHG emissions. For example, environmental activists helped to effectively stop the construction of nuclear power plants and new sources of nuclear power for more than 30 years by pushing bad regulatory and energy policy.[118] Nuclear power is the only zero-carbon technology available today (aside from hydropower, which is naturally concentrated on rivers that are already dammed) that could be commercially viable on a large scale. Yet an unpredictable policy environment and obsolete regulations have crushed nuclear power.[119]

To foster private energy development, innovation, and technological advancement, Congress should:

Allow Full Expensing for Research and Development and Capital Expenditures. Beginning in 2022, businesses were no longer allowed to deduct R&D expenses in the year they were incurred. Instead, those costs must be amortized over five years.[120] Similarly, the Tax Cuts and Jobs Act's provision allowing companies to fully and immediately deduct expenses on most capital investments begins to phase out in 2023, replaced by complicated depreciation schedules lasting as long as 20 years.[121] Instead of massively subsidizing activities that meet government-specified criteria (as the IRA does), Congress should remove misguided taxes against private innovation and allow companies to deduct valid expenditures on R&D and capital investments in the same year the companies bear those costs.

Control the Deficit. Coming full circle, Congress must control the deficit to avoid impeding private sector investment. The federal government has almost $31.9 trillion of public debt outstanding.[122] Rising public indebtedness drives up interest rates, raising the cost of acquiring capital and loans. Soaring interest rates especially harm innovators and businesses that fund high-risk, high-reward research projects, like R&D.[123] To ensure the availability of private capital to finance promising business ventures and investments (including those that might result in *commercially viable* energy technology advancements), Congress must control its spending.

Conclusion

The IRA will not accomplish much of what is claimed by its supporters. It will, however, centralize even more power in the federal government. It will impose higher taxes on businesses and individuals. It will pile on new federal spending and grant subsidies and government loans to favored industries. It will expand the IRS, complicate the tax code, and promulgate harmful regulations that will inhibit innovation. Congress should repeal this misguided legislation and get out of the business of picking winners and losers in the economy.

America faces many significant challenges. Many of those challenges—from the rapidly expanding debt to overregulation to cronyism to economic malaise—are the direct or indirect result of a bloated federal government. Instead of doubling down on policies that put more money and power in the hands of elected officials and bureaucrats in Washington, the American people should be given the room they need to flourish.

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