A Deeper Dive into the Inflation Reduction Act: The New Corporate AMT, Tax on Stock Buybacks and Certain Other Provisions

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As we briefly alerted a few weeks ago, on August 16, 2022, President Biden signed into law the Inflation Reduction Act, Publ. L. No. 117-169. This summary provides a more detailed analysis of certain tax provisions in the Act, including the new excise tax on stock buybacks and the definition of "applicable corporation" with regard to the new corporate minimum tax.

Corporate Alternative Minimum Tax

Summary: The Act imposes a new 15 percent corporate alternative minimum tax (the "CAMT") on certain large C corporations if such corporations' tax liability under the CAMT exceeds their regular federal income tax liability. Specifically, the new CAMT applies to an "applicable corporation," defined in Section 59 of the Internal Revenue Code of 1986, as amended (the "Code") as any corporation (except S corporations, Regulated Investment Companies, and Real Estate Investment Trusts) which meets the "average annual adjusted financial statement income (the "AFSI") test" for one or more tax years ending after December 31, 2021. A corporation satisfies the aforesaid test if its average annual AFSI for a three-taxable year period ending with the relevant taxable year is in excess of $1 billion. The tax base for the CAMT is the AFSI for the taxable year reduced by any CAMT foreign tax credit (generally based on the creditable foreign taxes taken into account on the applicable financial statements).

The three-taxable-year period means any three consecutive tax years preceding the tax year in which the tax applies. For instance, the three-taxable-year period for an applicable corporation possibly subject to the CAMT for the tax year 2023 (using a calendar year) would include calendar years ending on December 31, 2020, December 31, 2021 and December 31, 2022. Similarly, if a corporation first met the AFSI test for the 2023 tax year, it would be an applicable corporation beginning with the tax year 2024. If a corporation has been in existence for less than three taxable years, the AFSI income test is applied for the period during which the corporation has been in existence. For any tax year that is less than 12 months, the AFSI must be annualized.

Solely for purposes of calculating the $1 billion threshold, Section 59(k)(1)(D) was enacted to provide that all AFSI of persons treated as a single employer under the relevant provisions of the Code is included. In addition, any foreign-parented multinational group that includes at least one U.S. member may be subject to the tax if the U.S.

member exceeds a modified AFSI threshold of $100 million, and the average annual AFSI of the foreign-parented international financial reporting group exceeds $1 billion.

The Act adds Section 56A of the Code to define AFSI as net income or losses of a taxpayer reported on the taxpayer's "applicable financial statement," as that term is defined in Section 451(b)(3) of the Code, subject to certain adjustments. Different adjustments apply depending on whether the applicable corporation is part of a consolidated group, a partner in a partnership, or a U.S shareholder of one or more controlled foreign corporations, to name a few. Depreciation for AFSI purposes is calculated using tax depreciation rules, allowing for a reduction of AFSI by accelerated depreciation deductions, rather than financial accounting conventions.

Critically, as a general matter, a corporation only needs to meet the AFSI test for one tax year to become subject to the new CAMT. After that, it remains an applicable corporation even if its AFSI falls below the $1 billion level, unless and until there is an ownership change or the IRS determines otherwise (i.e., if the corporation fails the AFSI test for a specified number of consecutive years). The tax applies to taxable years after 2022. It is expected to generate $313 billion in tax revenue.

Takeaway: Although the $1 billion income threshold means that this new tax will apply only to the largest corporations, corporate executives and tax practitioners still need to understand the tax and perform the AFSI calculations to determine if the corporation is an "applicable corporation" to which the tax applies. The IRS is expected to issue regulations clarifying the new CAMT, including rules related to foreign-parented multinational groups.

Excise Tax on Repurchase of Corporate Stock

Summary: The Act imposes a 1 percent tax on certain repurchases of a "covered corporation's" stock during the taxable year for repurchases occurring after 2022. A "covered corporation" is generally defined as any U.S. corporation with stock that is traded on an established securities market (as defined in Section 7704(b)(1) of the Code) and includes any publicly traded corporation. The tax is imposed on the fair market value of the repurchased stock, reduced by the fair market value of such corporation's stock issuances in the same taxable year, including the fair market value of stock provided to employees.

For purposes of this provision, a "repurchase" includes a corporate acquisition of its own stock from a shareholder in exchange for property, whether or not the stock acquired by the corporation is cancelled, retired, or held as treasury stock. A repurchase also includes stock redemptions under Section 317(b) of the Code and transactions that the IRS deems "economically similar" to a redemption, and the purchase of a publicly traded U.S. corporation's stock by its "specified affiliate" (defined as any direct or indirect majority-owned subsidiary or partnership) from another person. Finally, the new tax also applies to repurchases or specified affiliate acquisitions of certain publicly traded foreign corporation stock. Where a foreign corporation is traded on an established securities market, the acquisition of such corporation's shares by a specified affiliate shall be treated as repurchase of shares by a covered corporation, with the specified affiliate treated as the covered corporation. An exception to this general rule applies where the specified affiliate is a foreign corporation or a foreign partnership (but excluding foreign partnerships with domestic entity as a direct or indirect partner). In that case, for purposes of calculating the 1% tax, the fair market value of the repurchased stock is not reduced by stock issuances to employees of the covered corporation, but rather, only by stock issuances to employees of the specified affiliate.

The Act provides for exceptions to the 1% tax for transactions where the total value of a company's repurchased stock during the tax year does not exceed $1 million, or for Code Section 368 tax-free reorganizations in which the shareholder recognizes no gain or loss, and also for repurchases contributed to employee sponsored retirement plans, employee stock ownership plans and certain other plans, and repurchases treated as dividends.

Takeaway: The stock buyback tax is more complicated than it appears, and corporate executives and tax practitioners need to be aware of it and its implications on a potential transaction. For example, it is not clear whether the tax will apply to certain merger-and-acquisition transactions, such as split-offs or transactions where a company is acquired for both stock and cash. It is also not clear whether redemptions of preferred stock are subject to the tax. IRS guidance is expected on the applicability of this new tax, and will likely include anti-abuse rules relating to the statutory exceptions.

Extension of Energy Tax Credits

The Act provides for $369 billion in energy security and climate change investments, and is aimed at reducing carbon emissions by approximately 40% by the year 2030. Specifically, the Act provides for a range of energy tax credits, including $9 billion in home energy rebate programs, and a new business tax credit of up to $7,500 for the purchase of zero-emission vehicles with a price tag of under $80,000. The Act also provides tax credits for fossil fuel companies, and tax incentives for contractors who manufacture or construct energy-efficient homes, producers of residential rooftop solar systems, and small wind energy systems, to name a few, as well as incentives for sourcing domestically manufactured steel, iron, and other energy related product components. The extensions and modifications of energy-related tax credits provided for under the Act are significant, and beyond the scope of this alert. For information on whether any of the new tax credits and extensions thereof can impact your business, contact one of the members of our team below.

Premium Tax Credit

The premium tax credit was originally enacted as part of the Affordable Care Act to help lower- and middle-income families pay for health insurance purchased through the healthcare marketplace. In order to qualify for the credit, the taxpayer's household income must have been between 100% and 400% of the federal poverty level for the taxpayer's family size. The American Rescue Plan Act (the "ARPA"), passed in response to the COVID-19 pandemic, changed that requirement for the 2021 and 2022 tax years, allowing taxpayers with income levels above the 400% poverty threshold to claim the premium tax credit for those two years. The Act now further extends the temporary exception to the 400% maximum threshold through the tax year 2025.

The Act also extends the reduced percentage of household income that is used to calculate the premium contribution for an individual claiming the premium tax credit. Prior to the enactment of the ARPA, the percentage of annual household income that taxpayers were required to contribute towards health care premiums ranged from 2% to 9.5%. The ARPA reduced those percentages to a range of 0% to 8.5% for the years 2021 and 2022. The Act further extends the lower percentages for three more years.

Research Credit for Small Businesses

The Act provides for an increased limit on the amount of research credit that qualified small businesses may elect to treat as a credit against their payroll tax liability. The credit limit is increased from $250,000 to $500,000 and applies to taxable years after 2022.

About the author:

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