

August 11, 2022

On August 7, 2022, the US Senate passed the Inflation Reduction Act (<u>House Resolution 5376</u>), which contains tax, climate and healthcare provisions. The legislation is widely expected to be passed by the House of Representatives without changes and signed into law by President Joseph R. Biden shortly thereafter. The Inflation Reduction Act contains a number of revisions to the Internal Revenue Code (the "Code"), including a 15% corporate alternative minimum tax and a 1% excise tax on corporate stock repurchases. Despite earlier proposals, the legislation does not contain any changes to the tax treatment of carried interest or the cap on deductions for state and local taxes.

This alert highlights a few key provisions of the Inflation Reduction Act that may be applicable to Cooley clients.

Corporate alternative minimum tax

In tax years beginning after December 31, 2022, the Inflation Reduction Act imposes a 15% alternative minimum tax (the "Corporate AMT") on US corporations with financial accounting profits exceeding a certain threshold. This provision is expected to impact large corporations that have previously reported high income on their financial statements but have significantly reduced – or even eliminated – their cash tax liability as a result of certain attributes or book-tax differences, such as companies with significant stock-based compensation. Very few corporations are expected to be subject to the Corporate AMT as currently proposed. In an analysis of an earlier version of the proposal, the Joint Committee on Taxation estimated that about 150 taxpayers would be subject to the tax each year.

The Corporate AMT would generally apply to US corporations – excluding S corporations, regulated investment companies and real estate investment trusts – with an average of more than \$1 billion of annual adjusted financial statement income (AFSI) during a three-year measurement period. The Corporate AMT would also apply to a US corporation (including, for these purposes, a trade or business engaged in by a foreign corporation within the US) in a foreign-parented multinational group if, over the three-year measurement period, the US corporation's average annual AFSI is at least \$100 million and the multinational group's average annual AFSI exceeds \$1 billion. A corporation's AFSI is the net income or loss set forth on the corporation's applicable financial statement (generally a Securities and Exchange Commission Form 10-K or other audited financial statement) for the taxable year, subject to certain adjustments to reflect accelerated tax depreciation and certain other items. The provision was amended with the intention that otherwise unrelated companies under common ownership of an investment fund will not have their AFSI aggregated for purposes of the \$1 billion threshold.

In some cases, the Corporate AMT may simply accelerate taxes, as payments made under the Corporate AMT can be used as a credit in future years when a corporation's regular tax liability exceeds its liability under the Corporate AMT. In other cases, the Corporate AMT may permanently increase overall tax liability. For example, taxpayers with significant net operating losses from tax years prior to 2020 may realize a permanent increase in tax liability because the Inflation Reduction Act precludes carryforwards for financial statement net operating losses arising in such years.

Excise tax on corporate stock repurchases

For publicly traded US corporations and certain US subsidiaries of publicly traded non-US corporations, the Inflation Reduction Act imposes a 1% excise tax on the fair market value of any stock that is repurchased by the corporation or its "specified affiliate" (generally, corporations or partnerships of which the corporation owns more than 50%) during the tax year. The taxable amount is reduced by the fair market value of any stock issued by the repurchasing corporation during the taxable year, including the fair market value of any stock issued or provided to employees of the corporation or a specified affiliate. The excise tax is subject to several exceptions (the contours of which are uncertain), including carve-outs for repurchases that are part of a tax-free reorganization, contributions to employee retirement or stock ownership plans, repurchases that are treated as dividends, and corporations that repurchase stock with a total value of no more than \$1 million during a taxable year. The excise tax applies to repurchases of stock after December 31, 2022.

While the excise tax only applies to repurchases of stock after December 31, 2022, corporations may already have shares outstanding that are subject to repurchase rights, including redeemable preferred stock and stock issued in the initial public offering of special purpose acquisition companies (SPACs). The excise tax could also be triggered in transactions not conventionally viewed as stock repurchases, including:

- Mergers or other reorganizations involving cash payments to the target's shareholders to the extent that such payments are funded with the target's cash or debt incurred or assumed by the target in the transaction.
- · Payments of cash in lieu of fractional shares.
- · Payments to dissenters.
- Divisive reorganizations that use a "split-off" structure.

In addition, the Secretary of the Treasury is authorized to define "repurchase" to include "economically similar" transactions. Unless the fair market value of stock treated as repurchased in a tax year is less than the fair market value of stock issued by the covered corporation in that tax year, or another exception applies, such transactions could expose a covered corporation to the excise tax.

Other tax provisions

Other notable tax-related provisions in the Inflation Reduction Act include:

- A two-year extension (to tax years beginning before January 1, 2029) of the loss limitation rules applicable to noncorporate taxpayers under Section 461(I) of the Internal Revenue Code.
- An increase in the research tax credit available to offset the payroll taxes of qualified small businesses under Section 41(h) of the Internal Revenue Code.
- An increase in IRS funding of approximately \$80 billion over 10 years, with nearly \$46 billion for enforcement efforts such as "digital asset monitoring and compliance activities."
- A new excise tax on drug producers who fail to comply with new drug pricing requirements.
- The reinstatement of a Superfund excise tax on crude oil and certain imported petroleum products at a rate of 16.4 cents per barrel (indexed to inflation) beginning January 1, 2023.
- The permanent extension of an excise tax on coal from US mines.
- · Climate- and energy-related taxes, tax credits and other incentives.

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