

August 10, 2022

Proposed Senate Legislation Would Impose Corporate Minimum, Excise Taxes; Increase Funding for IRS

On August 7, 2022, the Senate passed the Inflation Reduction Act of 2022 (the “Act”) that, among other provisions:

- i. Establishes a new 15% corporate alternative minimum tax for certain large corporations based on adjusted financial statement income,
- ii. Establishes an excise tax on public company corporate stock buybacks, and
- iii. Increases IRS funding.

In contrast, the Act does not include the proposal included in the original bill to expand the special holding period rules applicable to carried interest, which was discussed in our previous [Alert](#).

(i) 15% Corporate Minimum Tax

- **Overview:** The corporate alternative minimum tax (“AMT”) rules included in the Act are substantially similar to a proposal included in the Senate Finance Committee’s version of the Build Back Better Act released on December 11, 2021. If a corporation is subject to the AMT, the AMT would be 15% of the adjusted financial statement income (“AFSI”), reduced by certain AMT foreign tax credits based on taxes paid to foreign countries and included in the corporation’s applicable financial statement.
- **Scope – “applicable corporation”:** The AMT would apply only to an “applicable corporation,” which is generally a corporation with average annual adjusted financial statement income (“AAAFSI”) in excess of \$1 billion over any consecutive three-year period preceding the tax year at issue. An “applicable corporation” may also be a U.S. subsidiary of a foreign parent group if the group meets the test described above and the subsidiary has an AAAFSI of at least \$100 million over three consecutive tax years preceding the tax year at issue. Once a corporation meets the income test in any year, it will continue to be subject to the AMT in perpetuity, subject to an exclusion for corporations that do not meet the income test for a number of consecutive taxable years, with such number of years to be addressed in regulations, and that meet other requirements to be addressed in regulations.

Notably, an aggregation rule applies such that if a corporation is treated as a single employer with any other companies pursuant to Sections 52(a) or (b) of the Internal Revenue Code (the “Code”) (which generally is the case for companies under common control), the AFSI of those other companies is taken into account for purposes of the income test. (As originally proposed, the Act modified Section 52 for purposes of the AMT such that companies controlled by private equity funds would be aggregated under this rule, but late changes to the Act removed this modification.)

- **Exclusions:** The AMT does not apply to S corporations, regulated investment companies, or real estate investment trusts. The AMT also does not apply to corporations that experience an “ownership change,” to be addressed further in regulations, and that meet other requirements to be addressed in regulations.
- **Adjusted financial statement income:** A corporation’s AFSI for a taxable year is generally the corporation’s net income (or loss) set forth on the corporation’s applicable financial statement (e.g., financial statements that are

prepared in accordance with generally accepted accounting principles) with adjustments set forth in the Act, including:

- adjustments to account for any difference between the financial statement period and the taxable year;
- adjustments with respect to related entities to address a corporation's financial results being reported on consolidated financial statements, a corporation being part of a consolidated group and treatment of non-consolidated-group members;
- for a corporation that is a partner in a partnership, adjustments to include only the corporation's distributive share of the partnership's AFSI;
- for a corporation that is a United States shareholder of a controlled foreign corporation, adjustments to include a pro rata share of the income or loss of such controlled foreign corporation (except that the aggregate adjustment with respect to all controlled foreign corporations cannot be negative, with the excess only able to be carried forward to reduce the next year's positive adjustments with respect to controlled foreign corporations);
- for a foreign corporation, adjustments to apply the "effectively connected income" principles as reflected in Section 882 of the Code;
- adjustments to disregard U.S. federal and foreign income taxes deducted in an applicable financial statement;
- adjustments to take into account AFSI of a corporation's disregarded entities;
- for a tax-exempt entity, adjustments to take into account only income of an unrelated trade or business or income derived from debt-financed property treated as unrelated business taxable income;
- adjustments for reduction by depreciation deductions with respect to depreciable property to the extent of the amount allowed as deductions in computing the corporation's taxable income; and
- other adjustments in the regulations to be issued.

Further, a corporation's AFSI in a particular taxable year is reduced by an amount equal to the lesser of (a) the aggregate amount of financial statement NOLs carried over to such taxable year and (b) 80% of the corporation's adjusted financial statement income computed without regard to its financial statement NOLs. In that regard, the Act would permit a corporation to carry forward the financial statement NOLs generated for taxable years ending after December 31, 2019.

- Effective date: If passed into law, the AMT would become effective for taxable years beginning after December 31, 2022.

(ii) Excise Tax

- Overview: The Act also includes a 1% excise tax on the fair market value of stock repurchased by a publicly traded corporation. This provision is identical to the excise tax included in the proposed legislation known as the "Build Back Better Act" that the House Ways and Means Committee released on September 13, 2021.

- **Scope:** This provision imposes a 1% excise tax on corporations the stock of which is traded on an established securities market. The tax is imposed on the value of stock that is repurchased during the taxable year by the corporation or certain affiliates of the corporation. Affiliate for this purpose includes a corporation more than 50% of the stock of which is directly or indirectly owned by the corporation, or a partnership more than 50% of the capital interests of which are directly or indirectly held by the corporation.

The excise tax also applies to (i) purchases of stock of a publicly traded foreign corporation by a U.S. affiliate of such corporation, in which case the U.S. affiliate is liable for the excise tax, and (ii) stock repurchases by surrogate foreign corporations, which are foreign corporations subject to the inversion rules under Section 7874 of the Code.

A redemption of stock within the meaning of Section 317(b) of the Code, which generally is an acquisition of stock by the corporation from a shareholder in exchange for property, and any economically similar transaction as determined by Treasury are considered to be “repurchases” subject to the excise tax. In determining the amount of tax due, the value of stock repurchases in a particular tax year is reduced by the value of any new stock issuances that occur during that same year.

- **Exclusions:** There are a number of exclusions from the excise tax. The excise tax would not apply in the following circumstances:
 - the repurchase occurs as part of a tax-free reorganization under Section 368(a) of the Code and no gain or loss is recognized, such that the exclusion apparently does not apply if a shareholder receives boot in the reorganization;
 - the repurchased stock is contributed to an employer-sponsored retirement plan, employee stock ownership plan, or a similar plan;
 - the total value of the repurchased stock in any taxable year does not exceed \$1,000,000;
 - pursuant to regulations to be issued, the repurchase is made by a dealer in securities in the ordinary course of business;
 - the repurchase is by a real estate investment trust or regulated investment company; and
 - the repurchase is treated as a dividend for federal income tax purposes.
- **Impact on transactions:** The excise tax may affect transactions beyond public company share buy-back programs. For example, the excise tax may apply to shareholders of special purpose acquisition vehicles (“SPACs”) that redeem their shares pursuant to the SPAC’s initial formation or a “de-SPAC” transaction. The excise tax could also affect the manner in which so-called up-C IPOs are completed.

Given the breadth of the definition of “repurchase,” the excise tax may also apply to transactions that do not include stock repurchases as that term is commonly used, including acquisitions of public companies in which payments to shareholders are funded with proceeds of debt incurred or assumed by the company in connection with the acquisition.

- **Effective date:** If enacted, the excise tax would apply to repurchases made after December 31, 2022.

(iii) IRS Funding

Similar to the Build Back Better Act (released in December 2021), the Act provides nearly \$80 billion of additional IRS funding for taxpayer services, enforcement, operations support, and modernization, with more than \$45 billion designated for IRS tax enforcement over the next nine years.

(iv) Others

The Senate voted to extend the limit on excess business loss deductions from January 1, 2027 to January 1, 2029. The Senate had initially approved an amendment to the Act that would extend the \$10,000 cap on state and local tax deductions for one year; however, a subsequent vote overrode the extension and eliminated it from the Act. It subsequently approved the extension of the limit on excess business loss deductions to compensate for the revenue that would have resulted from extending such cap.