August 8, 2022

Tax Provisions in the Inflation Reduction Act of 2022

On August 7, the Senate passed the Inflation Reduction Act of 2022 (the "IRA"). The IRA would pay for significant climate spending through increased IRS enforcement funding and two new taxes: a 15% corporate minimum tax on book income of certain large corporations and a 1% excise tax on certain stock buybacks. The IRA is expected to become law promptly.

Corporate Minimum Tax on Book Income. Motivated by a desire to eliminate situations where large profitable U.S. corporations pay no federal income tax, the IRA would impose a 15% minimum tax on the "adjusted financial statement income" of certain large U.S. corporations (other than S-corporations, REITs and regulated investment companies), effective for taxable years beginning after December 31, 2022. The minimum tax generally would apply to corporations with average annual adjusted financial statement income, over a three-year period, in excess of $1 billion, if the minimum tax exceeds regular tax plus the base erosion anti-abuse tax. Adjusted financial statement income is net income in a corporation's audited GAAP financial statements filed with the SEC (or certain other specified financial statements) reduced by accelerated tax depreciation and financial statement loss carryovers (capped at 80% of adjusted financial statement income), among other adjustments. The IRA also allows a new foreign tax credit against the minimum tax and an indefinite credit carryforward for prior minimum tax against regular tax (if regular tax applies).

By introducing a parallel set of tax rules—with broad regulatory authority for the Treasury Department to "carry out the purposes" of the new tax—this minimum tax adds complexity to U.S. corporate taxation. The consequences of these rules for tax and accounting planning and decision-making and whether they will subject accounting standard setting bodies to new pressures remain to be seen. While the new minimum tax shares certain features with the OECD's "Pillar 2" (which also would impose a 15% minimum tax on the book income of certain large multinational enterprises), numerous differences give rise to complex coordination issues.

Excise Tax on Stock Buybacks. The IRA would impose a non-deductible 1% excise tax on the fair market value of stock repurchased after December 31, 2022 by publicly traded U.S. corporations (other than REITs and regulated investment companies). The value of stock repurchased is determined net of stock issued in the year, including pursuant to compensatory arrangements. Among other exceptions, the excise tax would not apply to buybacks that are part of a "reorganization" where no gain or loss is recognized by the redeemed shareholders, including many tax-free split-offs, and repurchases in which the stock is contributed to certain retirement, employee stock ownership or similar plans. Publicly traded corporations will need to consider this new excise tax in evaluating whether and how to return capital to shareholders. Cash dividends may become incrementally more attractive.

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