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Update: Senate Passes Revised Version of Inflation Reduction Act of 2022; Carried Interest Changes Omitted and Tax on Corporate Stock Buybacks Added

Client Alert | August 10, 2022

On August 7, 2022, the Senate voted 51-50 to pass the Inflation Reduction Act of 2022 (the "Act"), which broadly addresses climate change, taxes, health care, and inflation. The action sends the measure to the House of Representatives for a vote as early as Friday of this week. The House is expected to pass the $430 billion Act without amendments and send it to the White House for President Biden's signature. Federal agencies then would implement the law and promulgate rules as to the deployment of the funding.

Our previous alert analyzed proposed changes to U.S. tax law that were in an earlier draft of the legislation that was released on July 27, 2022. Consistent with the prior version of the legislation, the Senate-passed version of the Act includes a 15-percent corporate minimum tax, provides multi-year IRS funding with a dramatic increase in funding for tax enforcement, and extends and expands tax incentives for clean energy.

Notably, the Senate-passed version of the Act differs from the prior draft legislation in certain major respects, including that the Act (1) does not change existing law regarding the tax treatment of carried interests, (2) adds a one-percent excise tax on certain corporate stock buybacks, and (3) eases some of the effects of the new corporate minimum tax by, for example, taking into account certain depreciation and amortization deductions. A change relating to the corporate minimum tax in the draft legislation that may have adversely affected private equity funds was rejected.

Excise Tax on Stock Buybacks

As noted above, the Act introduces a one-percent excise tax on certain corporate stock buybacks. The proposal for the excise tax is identical to the excise tax that was proposed as part of the Build Back Better Act (H.R. 5376) at the end of 2021.

More specifically, the Act would impose a non-deductible one-percent excise tax on the fair market value of certain stock that is "repurchased" during the taxable year by a publicly traded U.S. corporation or acquired by certain of its subsidiaries. The taxable amount is reduced by the fair market value of certain issuances of stock throughout the year. On August 9, 2022, the Joint Committee on Taxation released its revenue estimate projecting that the excise tax will raise more than $73 billion in revenue over ten years.

A special rule would impose the tax on a publicly traded non-U.S. corporation that owns a U.S. entity that expatriated (as determined for U.S. tax purposes) after September 20, 2021. Another special rule would tax certain majority-owned U.S. subsidiaries in connection with certain acquisitions of the stock of their publicly traded non-U.S. parent corporations. (A publicly traded non-U.S. corporation's non-U.S. subsidiary that undertakes such an acquisition generally would not be subject to the tax, except in the

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case of a subsidiary non-U.S. partnership with a U.S. entity as a direct or indirect partner.[1])

A “repurchase” includes a “redemption” (generally, any acquisition by a corporation of its stock in exchange for cash or property other than the corporation’s own stock or stock rights) and any other “economically similar” transaction, as determined by the Treasury. Certain repurchases, however, would be specifically excepted from the excise tax. Those include: (1) a repurchase to the extent it is part of a tax-free reorganization and no gain or loss is recognized on the repurchase by the shareholder “by reason of” the reorganization, (2) repurchases followed by a contribution of the repurchased stock (or stock with an equivalent value) to an employee pension plan, employee stock ownership plan, or similar plan, (3) stock repurchases the total value of which does not exceed $1 million during the taxable year, (4) repurchases by a dealer in securities in the ordinary course of business, (5) repurchases by regulated investment companies or real estate investment trusts, and (6) a repurchase that is treated as a dividend for U.S. federal income tax purposes.

The excise tax has a potentially broad reach. For example, certain split-off transactions and leveraged acquisitions that constitute redemptions for U.S. federal income tax purposes may be “repurchases.” Further, the definition of “repurchase” includes transactions that are “economically similar” to redemptions (as determined by the Treasury), so it is possible that a wide range of other corporate transactions that would not constitute stock buybacks in the traditional sense may be subject to the excise tax.

The excise tax would apply to “repurchases” occurring after December 31, 2022.

Revisions to the Corporate Alternative Minimum Tax

In the course of Senate negotiations, one significant change was made to the Act’s 15-percent corporate alternative minimum tax and one potentially significant change was rejected:

- In a taxpayer-favorable development, the Act’s calculation of adjusted financial statement income was modified to allow depreciation generally (and amortization deductions for certain wireless spectrum specifically) to be computed using U.S. federal tax accounting methods, conventions, and class lives in lieu of corresponding financial statement principles. This modification will be beneficial to participants in industries that tend to make significant investments in property, plant and equipment (such as manufacturers). We also anticipate it will be a welcome development for sponsors of and investors in clean energy projects (which are further incentivized in the Act as described in our previous alert) because depreciation is one of the key tax attributes that is monetized by a tax equity investor in connection with a clean energy project financing transaction.
- A change to the rules for aggregating entities in applying the minimum tax’s $1 billion income threshold (previously proposed as part of the Build Back Better Act and incorporated in a revised draft of the legislation) that would have grouped together additional entities (including, notably, private equity funds) was rejected via an amendment from Senator Thune shortly before passage of the Act.[2] It is hoped that additional clarification or confirmation in the form of committee reports or legislative history will be forthcoming to give guidance and instruction to the IRS and Treasury regarding the import of this aspect of the Act.
- The Joint Committee on Taxation has projected that the minimum tax will raise more than $222 billion in revenue over ten years, a decline from the more than $318 billion in revenue that was projected to be raised from a similar provision included in the Build Back Better Act at the end of 2021.

Partnership Issues and Other Guidance Needs

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Significant guidance from the IRS and Treasury will be necessary to administer the tax law changes included in the Act, in particular with respect to partnerships. For example, the new 15-percent corporate alternative minimum tax requires a determination of an applicable corporation's "distributive share" of a partnership's "adjusted financial statement income" without providing guidance as to how that "share" is to be determined. In addition, the excise tax on corporate stock buybacks applies to stock acquired by a partnership that is majority-owned "directly or indirectly" by the corporation, but the statutory provision itself does not include any further rules for determining such ownership. Further, the new tax credit transfer regime has a rule addressing a transfer of an eligible credit by a partnership, but no rules for the subsequent treatment of an eligible credit transferred *to* a partnership.

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[1] The intended interaction of these rules with the "May Company" regulations of Treas. Reg. § 1.337(d)-3 is not entirely clear.

[2] In connection with this amendment, the disallowance of excess of business losses by noncorporate taxpayers under section 461(l) was ultimately extended for two years (through 2028).

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