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Biden signs landmark bill with corporate tax implications

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On August 16, 2022, President Joe Biden signed the Inflation Reduction Act (the Act) into law, which is expected to have a significant impact on climate, tax and health care policy in the United States. The result of intense negotiations among Democrats including Sen. Joe Manchin, D-W.Va., and Senate Majority Leader Chuck Schumer, D-N.Y., the Act sets a goal of reducing carbon emissions in the U.S. by 40% by 2030 and includes parts of the Build Back Better Act (BBBA).

In a three-part series of articles, we provide an outline of the Act's major provisions, which are designed to spur clean energy, implement a 15% minimum tax on corporations and lower prescription drug prices. To achieve its aim, the Act contains an array of grants, loans and tax credits for consumers and businesses — provisions that would affect industries ranging from automaking to utilities and energy.

A provision to modify the treatment of carried interests was removed during negotiations with Sen. Kyrsten Sinema, D-Ariz., a moderate and key vote, and was replaced by a 1% excise tax on stock buybacks by U.S. public corporations.

The Act sets a 15% corporate minimum tax rate on companies with profits of more than $1 billion.

Senate Democrats, who passed the measure through the budget reconciliation process on August 7, 2022, have said provisions in the Act will raise enough in revenue to balance out the new investments and reduce deficits over the next decade. Vice President Kamala Harris provided the tie-breaking vote to pass the bill following a marathon overnight session during which Republicans introduced a flurry of amendment votes. The House of Representatives passed the Act on August 12, 2022.

The key provisions outlined in this alert are related to corporate tax. The Act sets a 15% corporate minimum tax rate on companies with profits of more than $1 billion and includes new and expanded energy-related tax credits. It also imposes a 1% excise tax on stock repurchases by publicly traded companies.

Additionally, the Act budgets for additional Internal Revenue Service (IRS) enforcement resources, with the goal of bringing in $124 billion in tax revenue currently lost to fraudulent tax returns (after subtracting enforcement costs).

The Act is notable for what it does not include: increased tax rates on individuals and corporations or a repeal of the limitations on state and local tax deductions.

Given the complexity and magnitude of the Act's measures, please consult your Skadden contact for more information.

Corporate tax

The Act establishes various tax measures to raise hundreds of billions of dollars in revenue for the climate and clean energy initiatives (including new and expanded energy-related tax credits, discussed further below). It sets a 15% corporate minimum tax rate for companies whose profits exceed $1 billion, among other measures. A proposal to broaden the scope of the carried interest rule was dropped during negotiations with Sen. Sinema. Added into the revised bill is a 1% excise tax on stock repurchases by U.S. publicly traded corporations that was first proposed in the BBBA.

The Act is notable for what it does not include: increased tax rates on individuals and corporations or a repeal of the limitations on state and local tax deductions.

Corporate alternative minimum tax

The corporate alternative minimum tax (Corporate AMT) would apply to large corporations — generally those with financial statement income exceeding $1 billion, measured using a three-year average. At a high level, the AMT is designed to ensure that large corporations pay a minimum tax of 15% on their financial statement — or "book" — income. The current corporate tax rate is 21%, but some companies have had effective tax rates below 15% in certain years.

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Key points

- The new Corporate AMT would affect large corporations that are able to reduce their "cash tax" liability as a result of certain attributes or "book-tax" differences.
- A late-breaking amendment to the bill revised the application of the $1 billion income threshold to ensure that the provision does not apply to unrelated companies that are otherwise below the threshold but that are under common ownership of an investment fund, where the aggregation of their earning might have put them above the threshold. Such amendment was paid for by extending the excess business loss limitation provisions by two years.
- Corporations with large tax deductions that are not matched by book income deductions — for example, stock-based compensation — may face increased tax liabilities under the Act.
- The first draft of the bill did not include any special rules for accelerated depreciation, but the final bill reduces financial statement income in respect of accelerated depreciation (with corresponding increases in subsequent years), making it less likely that the new minimum tax will apply to many manufacturers with large capital expenditures.
- For some taxpayers, the proposed change would simply accelerate such additional taxes, since payments under the AMT can be used as a credit in future years when the regular tax liability exceeds the AMT. For others, the tax may represent a permanent additional tax, where tax deductions exceed book deductions on a permanent basis, for example in respect of stock-based compensation.
- Because the AMT is effective for tax years beginning after December 31, 2022, taxpayers should consider book tax differences that straddle that effective date and thus are treated similarly to permanent differences. For example, deductions taken into account for the 2022 taxable year will reduce tax in 2022 but later decrease the adjusted financial statement income (AFSI) if the corresponding book deduction is taken into account in a post-effective-date year.
- Finally, taxpayers with significant net operating losses from pre-2020 years may face a permanent additional tax liability under the new Corporate AMT, as such losses are not permitted to be carried forward.

How the corporate AMT is calculated

The Corporate AMT is based on a corporation's AFSI, which equals a corporation's income as reported on its applicable financial statements — generally its audited financial statements used for Securities and Exchange Commission (SEC) reporting or other nontax purposes. Special rules apply for calculating AFSI earned by consolidated groups, corporations that own interests in other nonconsolidated corporations (including foreign corporations) and corporations that own interests in partnerships.

In addition, AFSI generally includes a domestic corporation's pro rata share of the financial statement income of its foreign subsidiaries that are controlled foreign corporations (CFCs) as well as the income of "disregarded entities" owned by a corporation.

AFSI is reduced by financial statement losses carried over into a taxable year, subject to a limitation equal to 80% of financial statement income (similar to the net operating loss limitation for "regular" tax purposes), and, importantly, only in respect of losses for taxable years ending after December 31, 2019.

The Corporate AMT is then reduced by the AMT foreign tax credit, which is generally based on the foreign tax credits included on the financial statement income of a domestic corporation, plus a pro rata share of the foreign taxes reported on the financial statements of foreign subsidiaries of a domestic corporation, with a "haircut" to reduce those taxes to the 15% rate imposed by the Corporate AMT.

The Act revives a provision that imposes an excise tax on certain "repurchases" of stock by publicly traded U.S. corporations and certain of their affiliates, disadvantaging U.S.-parented public corporations vis-a-vis their foreign competitors.

Finally, the Corporate AMT can be reduced by general business credits, which are largely limited to 75% of a corporation's tax liability, but are not limited by the "tentative minimum tax" imposed by the AMT. Thus, corporate taxpayers may still be able to reduce their final tax liability below the 15% rate as a result of the availability of general business credits.

Stock repurchase excise tax[1]

The Act revives a provision previously included in the BBBA that imposes an excise tax on certain "repurchases" of stock by publicly traded U.S. corporations and certain of their affiliates, disadvantaging U.S.-parented public corporations vis-a-vis their foreign competitors. The provision included in the Act is substantively identical to the repurchase excise tax provision previously included in the BBBA. Under the Act, the excise tax would apply to repurchases occurring after December 31, 2022, irrespective of when the repurchase program was authorized.

The provision imposes a 1% excise tax on publicly traded U.S. corporations (and certain U.S. subsidiaries of publicly traded non-U.S. corporations) for the value of any stock that is repurchased during the taxable year by the corporation or "specified affiliates" in which the corporation owns a 50% or greater equity interest. A "repurchase" includes a "redemption" as defined under the U.S. tax code (generally, any acquisition of stock by the corporation 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 secretary of the Treasury.

Energy-related tax credits

The bill extends and expands key energy tax credit provisions that have supported the growth of the renewable energy sector and promote carbon capture, and introduces new tax credits intended to promote clean hydrogen and other efforts to mitigate greenhouse gas emissions.

New tax credits. New clean energy production credits (Section 45Y) and clean energy investment credits (Section 48D) would be created that would apply, on a technology-neutral basis (*e.g.*, without regard to energy source), to certain electricity facilities placed in service after 2024. The Section 48D credit would also apply to certain energy storage technology. Both credits would phase out for new facilities that begin construction after 2032 or after certain national emissions reduction goals are achieved, whichever is later. The Act would also create new credits for nuclear power production, clean vehicles, clean hydrogen, advanced manufacturing production and clean fuel production, as well as extend and/or expand several other existing energy-related credits.

Expanded energy production and energy tax credits. Section 45 renewable energy production credits (PTC) and the Section 48 energy credits (ITC) would generally be extended to eligible property or facilities beginning construction before 2025. The Act would also repeal the current phaseouts of these tax credits for property placed in service after 2021. Additionally, several new categories of property would be eligible for the ITC if placed in service after 2022, including certain energy storage technology, biogas projects, microgrid controller equipment, fuel cells using electromechanical processes and dynamic glass equipment. The Act would significantly reduce PTC and ITC amounts for projects that fail to meet new wage and apprenticeship requirements and that begin construction 60 or more days after the publication of Treasury guidance on such requirements.

Increased credit amounts. Projects that meet certain domestic content standards (*e.g.*, 100% of the iron and steel and an increasing percentage of the components are produced in the United States) or are located in certain "energy communities" (which include areas with employment or local tax revenues above specified thresholds related to fossil fuels and higher-than-average unemployment rates) and that otherwise qualify for the PTC, ITC, Section 45Y or Section 48D credit would be eligible for increased credit amounts. The Act would also direct the Department of the Treasury to ensure certain projects located in low-income communities receive an increased ITC.

> *The bill introduces new tax credits intended to promote clean hydrogen and other efforts to mitigate greenhouse gas emissions.*

Carbon capture and sequestration credits. The Act would expand eligibility for carbon capture and sequestration credits under Section 45Q by (i) extending the beginning of construction deadline for projects to 2032 (from 2025), and (ii) significantly lowering the amount of carbon that projects must capture annually. The Act would also materially increase the dollar amount of such credits (particularly for direct air capture), provided a project satisfies certain wage and apprenticeship requirements or begins construction prior to the date that is 60 days after the Department of the Treasury publishes guidance on such requirements. Additionally, the Act would make Section 45Q credits attributable to equipment placed in service after 2022 eligible for "direct pay" for the year the equipment is placed in service and the following four years, regardless of whether the entity claiming credits is a tax-exempt entity.

Tax credit transferability, direct pay, carryback. Under the bill, several energy-related credits would be (i) transferable to unrelated parties for cash, subject to certain requirements, (ii) eligible for "direct pay" if claimed by certain tax-exempt governmental and cooperative entities, and (iii) eligible to be carried back for up to three years.

Notes

[1] https://bit.ly/3AgduPw

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