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U.S. Climate Change and Healthcare Bill Moves Democrats' Tax Policy Forward

Authors: Peter Glicklich and Jennifer Lee

The *Inflation Reduction Act of 2022* (Act), which was signed into law on August 16, is intended to fight inflation and address climate change. The Act provides for over $360 billion in energy- and climate-related investments, including the expansion, extension and creation of numerous tax credits. The Act's new revenue raisers include an alternative minimum tax on the book profits of certain corporate groups with at least $1 billion of book income, an excise tax on stock buybacks by public U.S. corporations and increased funding for the Internal Revenue Service (IRS). The Act also extends the limitation in the *Tax Cuts and Jobs Act of 2017* on excess business losses of non-corporate taxpayers by an additional two years. Notably, the Act does not contain previous Democratic proposals to directly increase taxes on wealthy and high-income individuals such as the "billionaire's tax," proposed by Senator Ron Wyden, or changes to the "carried interest" rules.

Corporate Alternative Minimum Tax

Proposed to be effective for tax years beginning after December 31, 2022, the Act would impose a 15% minimum tax on a corporation's profits as reported in its financial statements, with certain adjustments. Only corporations with average annual adjusted financial statement income in excess of $1 billion in the prior three years would be subject to the tax. The tax has been modified from previous versions of the proposal to reduce the impact to manufacturers and private equity firms. For corporate groups with a foreign parent, all members of that foreign parent's international financial reporting group would be included for purposes of determining whether the $1 billion annual average income threshold is met with respect to the group. U.S. members of a foreign-parented group that meets the $1 billion threshold would be subject to the minimum tax only if the average annual adjusted financial statement income of the U.S. members of the group in the prior three years is $100 million or more.

For example, consider two Canadian-parented corporate groups with U.S. members that have average annual adjusted financial statement income of (a) $900 million but all of that income is derived by the U.S. members of the group and (b) more than $1 billion but its U.S. members have only $50 million of book income. The new minimum tax will not apply to the group described in (a) because the group's total book income is below the $1 billion threshold for the tax to apply to any corporate group. The group in (b) will also not be subject to the tax because the U.S. members of the group have income below the $100 million threshold for the tax to apply to foreign-parented groups.

Excise Tax on Stock Buybacks

The Act provides for a new excise tax on "Covered Corporations" repurchasing their shares themselves or through a "Specified Affiliate" after December, 31, 2022. A Covered Corporation is a U.S. corporation that is publicly traded on an established securities market. A Specified Affiliate is (i) any corporation whose stock is directly or indirectly more than 50% owned by the Covered Corporation (by vote or value) or (ii) a partnership whose interests are directly or indirectly more than 50% owned by the Covered Corporation. The tax would be equal to 1% of the fair market value of the stock repurchased. The value of repurchased stock would be netted with the value of certain new issuances, including stock issued to the corporation's employees as compensation. This new tax may reduce the popularity of stock buybacks in favour of paying dividends. It may also encourage corporations to issue more stock to their employees to support additional buybacks.

Funding for IRS

Over the next 10 years, the Act appropriates $79.6 billion for the IRS to put toward additional enforcement, customer service, modernization and operational support efforts. Approximately half of the new funding is earmarked for increased enforcement efforts, which the IRS says it will use to collect more from large corporations and global high-net-worth taxpayers. The Congressional Budget Office estimates that the influx of funding will bring in an additional $124 billion in tax revenue over the 10 years.

Conclusion

While limited in scope compared with its previous tax proposals, the Act represents an important step in the Biden administration's ability to move its tax policy agendas forward, albeit very slowly, when tied to incentives and popular non-tax initiatives. The new taxes in the Act will mainly affect only the largest companies. However, private equity firms will need to assess whether their portfolio companies will be aggregated for purposes of determining whether the new minimum book tax will apply to them. Stock buybacks are not likely to be significantly curtailed by the buyback tax, but increases to the rate could be in store and may therefore impair buyback strategy.

Finally, if the Democrats maintain or extend their majorities in Congress in the coming midterm elections, the remainder of Biden's tax agenda (as outlined in the administration's "Green Book" and the *Build Back Better Act* (BBBA)) could follow on the heels of the Act's passage. If the evolution of the tax provisions from the BBBA to the *Inflation Reduction Act* is any indication, however, then additional meaningful tax reform would appear to be unlikely absent significant victories for the Democrats in the midterm elections.

Key Contacts: Peter Glicklich, Michael N. Kandev and Christopher Anderson