Inflation Reduction Act

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On August 16, 2022, President Biden signed the Inflation Reduction Act of 2022 ("IRA") into law. While much of the legislation is geared towards climate change mitigation, clean energy, and provisions to promote health care affordability, this client alert will focus on some corporate and tax impacts of the legislation.

With limited exception, these provisions apply to taxable years beginning after 2022.

Extension of Limitation on Excess Business Losses of Noncorporate Taxpayers

The Excess Business Loss ("EBL") limitation went into effect in tax year 2021 and limited the amount of trade or business deductions that noncorporate taxpayers can offset nonbusiness income to $250,000, or $500,000 for a joint return, with the thresholds indexed for inflation.

The IRA extends the EBL limitation on by two years. Instead of expiring at the end of 2026, the losses will be disallowed for taxable years through 2028.

Increase in Research Credit Against Payroll Taxes for Small Businesses

Prior to the IRA, qualified small businesses were permitted to use up to $250,000 of their qualified Research and Development credits ("R&D Credits") to offset the 6.2% portion of their Social Security payroll tax liability. The IRA provides for an additional $250,000 of R&D Credits that can be used to offset the 1.45% employer portion of Medicare payroll tax liability.

Revised Corporate Alternative Minimum Tax

A new corporate alternative minimum tax ("AMT") imposes a tax equal to 15% of a corporation's adjusted financial statement income ("AFSI") to the extent that such amount exceeds its corporate AMT foreign tax credit. The AMT applies to 'C' corporations which, for a three taxable year period, have average annual AFSI greater than $1 billion (and at least $100 million for members of foreign-parented international financial reporting groups).

AFSI is the net income or loss set forth on an applicable financial statement, with certain adjustments. The IRA provides rules for calculating AFSI for certain entities and income (e.g., consolidated groups, foreign-parented groups, effectively connected income) and allows for a reduction in AFSI by accelerating depreciation deductions.

The AMT will impact a relatively small number of companies. In 2021, 368 companies made enough to cross the threshold into corporate AMT territory, and of those, only 127 paid less than the required 15% rate.

Excise Tax on Repurchase of Corporate Stock

The IRA imposes a new 1% tax on the fair market value of stock repurchased by a publicly traded U.S. corporation during the taxable year, net of stock issuances that occur during the taxable year.

The excise tax will apply to a redemption of stock in accordance with IRC §317(b) and economically similar transactions, including a corporation's repurchase of stock from its shareholders (regardless of whether the acquired stock is cancelled, retired, or held as treasury stock), stock acquired by a corporation's specified affiliate from another person, and certain acquisitions and repurchases of publicly traded foreign corporation stock.

The excise tax has exceptions for (1) Code Section 368 tax-free reorganizations, (2) total repurchased stock of $1 million or less in the taxable year, (3) repurchases that are treated as dividends, (4) repurchases by regulated investment companies, or real estate investments trusts, (5) stock contributed to retirement accounts, pensions, or employee stock ownership plans, and (6) certain other miscellaneous transactions.

No Change to Carried Interest

Carried interest is income paid to investment managers (i.e., the general partner of a partnership) to treat what is functionally their income (normally taxed at a top federal rate of 37%) as capital gains (taxed at a top federal rate of 23.8%). The capital gain treatment is permitted under Section 1061 of the Code and its regulations.

Despite one of the IRA's primary sponsors trying to eliminate capital gains treatment for Carried Interest as part of the IRA, such provisions were not included due to Congressional negotiations, and this perennially endangered treatment survives intact for the benefit of asset fund managers.

Conclusion

While much of the focus of the IRA is to address climate change, incentivize clean energy, and promote health care affordability, it is important to be aware that the IRA contains tax provisions that will impact many small and large companies. The above non-exhaustive list is intended to flag some notable provisions, but taxpayers should expect the US Treasury to issue guidance and for the IRS to provide new or updated tax forms that will allow for a clearer means of implementing applicable provisions.

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