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Understanding the Inflation Reduction Act of 2022

On August 16, 2022, the Inflation Reduction Act of 2022[1] ("the Act") was signed into law, implementing a number of initiatives, including a new corporate minimum tax and a new excise tax on stock buybacks.

Corporate Minimum Tax

The Act creates a new 15% corporate minimum tax. The tax generally applies to any company[2] with adjusted financial statement[3] income of $1 billion or more in at least one year that ends after 2021. While the tax takes effect in 2023, the calculation averages the current year and two preceding years that began after 2021.[4] The Joint Committee on Taxation predicts that it will affect about 150 companies in the United States.[5]

A corporation that becomes subject to the minimum tax remains so in subsequent years, unless:

- It has a change of ownership (to be defined in future regulations) or has a series of consecutive years in which they did not meet the minimum adjusted financial statement income test (also to be explained in future regulations); *and*
- The Secretary determines that it would not be appropriate to apply the tax.[6]

Regulations are required under the Act to clarify these and other issues.

Companies that are affected by the new tax will find that nonqualified deferred compensation plans they offer will have the following impacts on adjusted financial statement income:

- Deferrals do not affect financial statement income, but employer contributions that are vested will decrease financial statement income. To the extent that the minimum tax applies, employer contributions will decrease the amount subject to this tax. Whether this is material will depend on the amount of employer contributions, and the extent to which adjusted financial statement income exceeds $1 billion.
- Distributions will reduce taxable income but not financial statement income.
- Generally, for companies that informally finance their plans with either mutual funds or corporate-owned life insurance (COLI), the gain or loss on these assets will offset the increase or decrease in plan balances on adjusted financial statement income.
- COLI death benefits will increase financial statement income and therefore will potentially be subject to the minimum tax. Generally, companies may get a minimum tax credit in the future when the company becomes subject to regular tax.

The new tax takes effect for taxable years beginning after December 31, 2022.[7]

Excise Tax on Stock Buybacks

The Act creates a new excise tax of 1% on stock buybacks by publicly traded companies.[8] This tax applies to the fair market value of all shares repurchased by a company, offset by the fair market value of all shares issued by the company in the same tax year, but only if this net amount exceeds $1 million. The tax similarly applies when an affiliate (a company that is owned at least 50% by the covered company) purchases the issued shares.

There are a few notable exceptions when the excise tax does not apply.[9] These include:

- To the extent that the repurchase is part of a reorganization and no gain or loss is recognized as a result of it;
- When the repurchased stock (or an amount of stock equal in value) is contributed to an employer sponsored retirement plan, employee stock ownership plan (ESOP), or similar plan.

ESOP repurchases are not subject to this excise tax. However, for C corporations that finance ESOP repurchases with COLI, COLI gains and death proceeds would increase the financial statement income for purposes of the minimum tax.

This provision applies for repurchases of stock beginning after December 31, 2022.[10]

[1] Public Law No: 117-169, Sec. 10101(f). The legislation also includes prescription drug and Medicare reforms, IRS appropriations, and a wide range of energy initiatives.
[2] The minimum tax does not apply to the following types of companies: (i) S corporations; (ii) regulated investment companies (i.e., generally mutual funds); (iii) real estate investment trusts (REITs). IRC Sec. 59(k)(1)(A), as added by Act Sec. 10101.
[3] Widely described as “book income.”
[4] See IRC Sec. 59(k). The three-year annual average is calculated using the income from the current year and one or more preceding years ending after December 31, 2021. If the company has not existed for three years, the tax is applied on the basis of the period during which the corporation was in existence. IRC Sec. 59(k)(1)(E)(i).
[5] Domestic companies that are part of a foreign-parented multinational group are subject to a different threshold.
[6] See IRC Sec. 59(k)(1)(C), as added by Act Sec. 10101(a).
[7] Act Sec. 10101(f).
[8] IRC Sec. 4502(b), as added by Act Sec. 10201. The tax applies to “covered corporations,” which means both domestic corporations and partnerships that are traded on an established securities market. IRC Sec. 7704(b)(1).
[9] The full list of exceptions is as follows: (1) to the extent that the repurchase is part of a reorganization (within the meaning of section 368(a)) and no gain or loss is recognized on such repurchase by the shareholder under chapter 1 by reason of such reorganization, (2) in any case in which the stock repurchased is, or an amount of stock equal to the value of the stock repurchased is, contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan, (3) in any case in which the total value of the stock repurchased during the taxable year does not exceed $1,000,000, (4) under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business, (5) to repurchases by a regulated investment company (as defined in IRC Sec. 851) or a real estate investment trust, or (6) to the extent that the repurchase is treated as a dividend for purposes of Title 1 of the Act. IRC Sec. 4501(e), as added by Act Sec. 10201.
[10] Act Sec. 10201(d).

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