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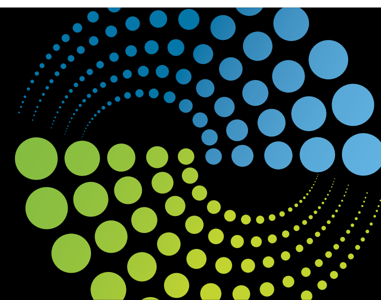
M&A Tax Talk

Inflation Reduction Act of 2022: Welcoming back Corporate AMT 2.0



The Biden administration was able to make some major tax policy changes before the 2022 midterms. This article provides a high-level overview of the Inflation Reduction Act's tax law changes to corporate taxes and the potential impact on M&A transactions

Setting the stage

In 2022, Congress approved and President Biden signed into law the Inflation Reduction Act ("IRA," P.L. 117-169), a roughly $740 billion tax-and-spending package intended to address, at least in part, the president's overarching policy goals of ensuring large businesses and wealthy individuals pay "their fair share" in taxes, reducing tax burdens for low- and middle-income taxpayers, promoting climate change mitigation, and expanding health care affordability.

Broadly speaking, the IRA, which became law on August 16, 2022, includes several direct tax increases on businesses. It also provides a substantial infusion of new mandatory funding (over 10 years) for the Internal Revenue Service to enhance the agency's audit and enforcement programs in an effort to reduce the "tax gap"—the difference between the amount of tax legally owed to the government and the amount timely paid and collected—and to overhaul its information technology and customer service operations. Revenue generated from the new tax increases and from capturing previously uncollected taxes is intended to offset the cost of a host of tax incentives in the new law aimed at promoting clean energy and mitigating climate change, as well as provisions reducing certain health care costs.

The IRA moved through the Democrat-controlled Congress under fast-track budget reconciliation rules that allowed party leaders to avert certain procedural hurdles in the Senate and essentially obviated the need for Republican support—a dynamic that was reflected in the vote tallies on both sides of the Capitol. The measure cleared the Senate (on August 7) by a margin of 51-50, with all 50 Democrats aligned in the "aye" column, all 50 Republicans voting "no," and Vice President Kamala Harris breaking the tie. It was approved in the House (on August 12) by a strict party-line vote of 220-207.

This article provides a high-level overview of three areas in which the IRA made significant changes to corporate tax law and considers their potential impact on M&A transactions. Specifically, it looks at (1) the new corporate book-income alternative minimum tax (CBIAMT), (2) the new excise tax on stock buybacks, and (3) the expansion of clean energy tax incentives. As always, the devil is in the details, so Treasury regulations and guidance will be crucial to understanding some of the complexities of these provisions.

Corporate book-income AMT (CBIAMT)

The IRA imposes a new 15% minimum tax on "adjusted financial statement income" (AFSI) of applicable corporations over the "corporate AMT foreign tax credit for the taxable year."

Under the CBIAMT, an "applicable corporation's" (AC) minimum tax is equal to the amount by which the tentative minimum tax exceeds the sum of a corporation's regular tax for the year and its BEAT liability under section 59A. Although similar to certain minimum tax proposals that have been floated by various congressional lawmakers but never became law, the CBIAMT as enacted includes a few noteworthy revisions, such as:

- A modification to the language addressing the amount of income that is taken into account and attributable to the holding of stock in a corporation that is not a member of the US consolidated group. In such cases, AFSI of the taxpayer with respect to such corporation shall be determined by only taking into account the dividends received from such other corporation. It is thought this adjustment is intended to exclude amounts otherwise taken into account with respect to stock under the mark-to-market method of accounting.
- A special rule addressing the treatment of amounts attributable to defined benefit pension plans and tax-exempt income.
- Provisions allowing for reductions to AFSI for (1) depreciation deductions allowed under section 167 with respect to section 168 property and (2) amortization deductions allowed under section 197 with respect to "qualified wireless spectrum." When these provisions are applicable, AFSI is adjusted to disregard any amount of depreciation or amortization expense that is taken into account in the taxpayer's applicable financial statement with respect to such property and qualified wireless spectrum and substitute the amount taken into account in computing regular tax.

The CBIAMT is effective for taxable years beginning after December 31, 2022

A detailed discussion of the new book-minimum tax is available from Deloitte Tax LLP.

M&A Implications

At the end of the day, the CBIAMT is likely to only apply to a very few US based corporate taxpayers. There are exceptions that have been provided that will have the effect of excluding a number of large entities from these rules, such as: (i) related entities held under common ownership of an investment fund (as the fund is not engaged in a trade or business); (ii) allowing companies to use tax (rather than book) depreciation; and (ii) excluding certain stock related mark to market book income.

The CBIAMT will likely generally be a timing difference for companies.

M&A transactions will need to be cognizant of these rules if (i) they plan to acquire a Target from an AC or (ii) if the acquisition of the Target will bring the Acquirer closer to AC status. The general rule is that "once an AC, always an AC." Fortunately, the statute contemplates a solution, under regulations provided by the Secretary, if there is an ownership change and Treasury determines "it would not be appropriate to treat" the corporation as an AC. On December 27, 2022, the Treasury Department and Internal Revenue Service ("IRS") issued Notice 2023-07, which is the first issuance of interim guidance on CBIAMT until the proposed regulations are issued and on which Taxpayers are allowed to rely. Notice 2023-07 provides guidance on many issues, including guidance on certain acquisition and section 355 transactions where it would not be appropriate to treat the Target as an AC.

With regard to both large US based ACs and large "foreign-parented multinational groups" (FPMG) that are large enough to be concerned about meeting the $1B book income threshold, part of the M&A process going forward will have to be keeping a watchful eye on whether the next M&A acquisition might push them over the $1B book income threshold and subject the entire company to CBIAMT going forward.

For a US based AC, this is relatively straightforward – does any acquisition likely get them close to the $1B threshold?

For a FPMG, this may be more complicated as they will not only have the same concern about any US acquisitions pushing them over a lower $100M threshold but they may also be concerned about the $1B overall AFSI threshold for non-US acquisitions. For example, if a FPMG has less than $1B in global book income but has more than $100m in US AFSI, that FPMG will have to keep a CBIAMT watchful eye on non-US M&A acquisitions that might push its global book income over the $1B threshold, and thus, the FPMG would meet both prongs of the FPMG CBIAMT test.

Both US based ACs and FPMGs that are close but do not currently meet the applicable thresholds may want to combine any M&A activities with potential restructuring or other transactions that may postpone the application of the CBIAMT.

For companies that will eventually be subject to OECD Pillar 2 requirements, the CBIAMT is likely not a tax that will not count as a Pillar 2 tax.

1% excise tax on stock buybacks

The IRA adds new Internal Revenue Code section 4501 to provide that a "covered corporation" is subject to an excise tax equal to 1% of the fair market value of any stock of the corporation that is repurchased by such corporation during any taxable year (the "excise tax").

A covered corporation means a domestic corporation, the stock of which is traded on an established securities market.

Purchases of covered corporation stock by specified affiliates (generally, more than 50%-owned subsidiaries) would be treated as repurchased by the covered corporation. For purposes of calculating the excise tax, the fair market value of the repurchased stock is reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including stock issued or provided to employees of the covered corporation and employees of specified affiliates. The tax also applies to repurchases of stock of certain publicly traded foreign corporations.

The excise tax is applicable to repurchases of stock made after December 31, 2022.

A detailed discussion of the stock buyback excise tax is available from Deloitte Tax LLP

M&A implications

A repurchase of stock is defined as a redemption within the meaning of section 317(b), which means an acquisition by a corporation of its own stock from a shareholder in exchange for property (other than the corporation's own stock or rights to acquire such stock). A repurchase also includes any transaction set forth in future guidance that is determined to be economically similar to a redemption of stock. US public company stock buyback programs clearly fall under the scope of this provision and will have to be considered an additional cost of such transactions (subject to any reduction for stock issued during the taxable year).

In addition, other transactions could be treated as repurchases if such repurchases would be characterized as redemptions under section 317(b). For example, a leveraged buyout transaction can be treated as a redemption of target corporation stock to the extent funds are sourced from merger subsidiary indebtedness or target corporation cash on hand.

The excise tax contains several exceptions to repurchases of stock. One exception provides that the excise tax does not apply to the extent that the repurchase is part of a section 368(a) reorganization and no gain or loss is recognized on such repurchase by the shareholder by reason of the reorganization. However, to the extent the reorganization involves cash or other boot, the scope of the exception is not clear and likely will require guidance from Treasury or the IRS.

In addition, there are other exceptions, including: (i) contributions of the repurchased stock (or an amount equal to the value of the repurchased stock) to certain retirement or ESOP plans, (ii) the total value of stock repurchased during the taxable year is less than $1m per year, (iii) ordinary course of business for securities dealers, (iv) RIC or REIT repurchases, and (v) redemptions treated as a dividend under section 301 (to the extent of earnings and profits).

These excise tax rules are likely to impact M&A transactions in three ways:

First, due diligence will need to include whether any 2023 and later transactions included transactions that could be subject to the excise tax and whether any such transaction was reported correctly, and the excise tax was paid (taking into account any available exceptions or reductions).

Second, any M&A related structuring will need to take into account the additional cost of the excise tax if it involves a covered repurchase of stock. As mentioned above, the tax can potentially apply to M&A transactions, including section 368 reorganizations with cash consideration.

Third, SPACs, which have a limited time to consummate an acquisition or they must liquidate (e.g., after 18 or 24 months). Some SPAC acquisitions historically have included redemptions that now may be subject to the excise tax (although an offset for newly issued stock by the SPAC during the same taxable year (e.g., a PIPE transaction) may partially or fully offset the redemptions). Accordingly, the impact of the excise tax will need to be taken into account. Alternatively, if the SPAC must liquidate, the excise tax may apply to liquidating distributions to SPAC shareholders. Treasury or IRS guidance may be forthcoming on this topic.

Clean energy incentives

The IRA includes a number of tax and nontax provisions that are intended to bring down consumer energy costs, increase American energy security, and reduce greenhouse gas emissions. According to an analysis from the Office of Management and Budget, the new law is expected to put the US on a path to roughly 40% emissions reduction (compared to 2005 levels) by 2030.

Certain tax credits include options for a taxpayer to claim a direct payment in lieu of those credits. Some tax credits may also be transferred (i.e., sold) to another taxpayer.

Promoting American energy security and domestic manufacturing: The IRA provides tax and nontax provisions intended to improve reliability of the US energy grid and promote domestic clean energy manufacturing.

Among the tax-focused provisions are production tax credits to accelerate US manufacturing of solar panels, wind turbines, and critical minerals processing. Also included is an investment tax credit to build clean technology manufacturing facilities that produce electric vehicles, wind turbines, solar panels, and similar clean energy property.

Decarbonizing the economy: The IRA provides an array of tax and nontax provisions aimed at reducing emissions from energy production, transportation, industrial manufacturing, buildings, and agriculture.

Specifically, it includes tax credits for investments in clean sources of energy and energy storage, tax credits for producing clean fuels and purchasing clean commercial vehicles to reduce emissions within the transportation sector, and tax credits for reducing emissions from industrial manufacturing processes.

Supporting farmers, forestland owners, and rural communities: The IRA promotes investments in clean energy development in rural communities, including through tax credits to support the domestic production of biofuels and to build the infrastructure needed for sustainable aviation fuel and other biofuels.

Reducing consumer energy costs: The IRA extends a number of tax credits aimed at bringing down the cost of residential energy-efficiency improvements such as heat pumps, rooftop solar systems, and electric HVAC systems and water heaters.

The new law also includes a $4,000 credit to make it more affordable for certain lower- and middle-income individuals to purchase used clean-energy vehicles. A credit of up to $7,500 is available for the purchase of certain new clean-energy vehicles.

Supporting the US workforce: Many of the IRA's energy-related incentives include enhanced tax benefits (i.e., increased tax credits or deduction amounts) for taxpayers who meet certain prevailing wage and apprenticeship requirements.

Promoting environmental justice: To support the goal of expanding environmental justice efforts, many of the IRA's clean-energy tax credits include either a bonus rate or set-aside for investments in economically distressed communities.

A detailed discussion of the IRA's sustainability provisions is available from Deloitte Tax LLP.

M&A implications

The IRA reinstates and expands many clean energy incentives. These changes will effectively provide tax subsidies to companies' efforts to meet their environmental, social and governance (ESG) goals. As the IRA has made these clean energy investments more lucrative, we expect to see increased interest in clean energy investment and acquisitions from both US and non-US investors in the future.

Conclusion

While the IRA legislation has now been passed, the regulations have yet to be drafted, which leaves uncertainty on the interpretation of the IRA legislation that is effective for tax years beginning on or after December 31, 2022. In the meantime, there will likely be unknowns when working with M&A transactions over the next few months as things evolve around the IRA until guidance is provided, but it is important to start evaluating the potential outcomes and considering the appropriate actions to take.

Want to learn more?

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