Summary of the Relevant Federal Tax Provisions in the Inflation Reduction Act

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President Joe Biden signed the Inflation Reduction Act (Act) into law on August 16, 2022. The Act raises approximately $730 billion in revenue over ten years and contains several provisions that are part of President Biden's economic agenda. The Act contains a number of tax provisions of interest to HCVT clients, including:

- A 15% corporate alternative minimum tax on adjusted book income (Corporate AMT);
- A 1% excise tax on corporate stock repurchases;
- A number of clean energy tax incentives, including extensions and modifications to credits for electricity produced from certain renewable resources, increases to energy credits for solar and wind facilities, and clean energy and efficiency incentives for individuals; and
- An $80 billion increase in funding over 10 years for the Internal Revenue Service (IRS).

Just as notable, a number of provisions that were originally contained in the Act were removed. The provisions that were removed and are of interest to HCVT clients include:

- Modifications to the carried interest rules that would have extended the holding period requirements for taxpayers with adjusted gross income over $400,000; and
- Amendments to the Corporate AMT to remove private-equity controlled groups from being subject to the Corporate AMT.

What follows is a discussion of the above-mentioned provisions of the Act, including some initial observations on how they will impact taxpayers.

Corporate AMT Tax Overview

Starting in tax years beginning after December 31, 2022, the Corporate AMT will be imposed on any corporation (other than an S corporation, RIC or REIT) or group of corporations treated as a single corporation that has average adjusted financial statement income in excess of $1 billion over any consecutive three-year period preceding the tax year at issue. In addition, U.S. subsidiaries of a foreign multinational enterprise would be subject to the Corporate AMT if the foreign-parented group has adjusted financial statement income greater than $1 billion and the U.S. corporate group has average annual adjusted financial statement income greater than $100 million. The adjusted financial statement income will be determined by reference to the income set forth in a corporation's audited financial statements, subject to certain adjustments such as earnings from a controlled foreign corporation, corporations filing consolidated returns, partnerships, and certain taxes paid. Corporations subject to the Corporate AMT are eligible to claim financial net operating losses, but net operating losses are generally limited to: (1) financial net operating losses incurred in taxable years ending after December 31, 2019; and (2) 80% of the corporation's adjusted financial statement income. Corporations subject to the Corporate AMT must pay the difference between their liability under the Corporate AMT and their regular tax liability as computed under the tax code.

The final provisions of the Corporate AMT also contain negotiated changes to the original text that preserve the ability of corporations to reduce adjusted financial statement income by accelerated depreciation deductions and amortization attributable to the purchase of qualified wireless spectrum (which may not otherwise be amortizable for book purposes). In addition, further negotiated changes modified the rules relating to determining corporate group status for purposes of the Corporate AMT. These changes, raised by Senators John Thune (R-S.D.) and Kyrsten Sinema (D-A.Z.), removed language that could have resulted in private equity funds and their portfolio companies constituting a group of corporations for purposes of calculating the $1 billion adjusted financial statement income threshold, and thus potentially subjecting private equity funds and their portfolio companies to the Corporate AMT.

Observations Regarding the Corporate AMT

- For now, private equity funds and their portfolio companies have avoided directly being subject to Corporate AMT through the removal of language in the final text that modified the definition of a corporate group and how corporations are aggregated for purposes of measuring the $1 billion adjusted financial statement income threshold. But going forward, private equity funds that could potentially be subject to the Corporate AMT under a modified definition of a corporate group should monitor the issuance of regulatory guidance as the U.S. Treasury Department and the IRS could presumably write regulations extending the Corporate AMT to the private equity industry.
- The Corporate AMT should not be confused with international tax proposals that are currently being debated, such as the Organization for Economic Cooperation and Development's so-called Pillar Two

approach that seeks to encourage the global adoption of a minimum tax of 15% on the book earnings of corporations (as determined on a country-by-country basis). While the Corporate AMT results in certain corporations paying a minimum tax of 15% on adjusted financial statement income, it does not result in an alignment of the current U.S. international tax rules under the global intangible low tax income regime and foreign tax credit rules with Pillar Two and its proposed adoption of a minimum tax regime. Thus, questions still remain about the fate of Pillar Two, such as whether the U.S. and/or other countries will eventually adopt it.

- Several opponents of the Corporate AMT have noted that a taxed based on financial statement income will make the tax code more complicated and has been tried before. In addition, opponents have noted that a minimum tax based on book income may actually damage the quality of information that public companies report to shareholders and creditors by incentivizing companies to adjust their financial accounting to help mitigate U.S. tax liabilities.

Excise Tax on Corporate Stock Repurchases Overview

The Act creates a new provision to the tax code that imposes a non-deductible excise tax on “covered corporations” that repurchase their shares either themselves or through a “specified affiliate” after December 31, 2022. The tax is equal to 1% of the fair market value of the stock repurchased by the covered corporation or its specified affiliate. A covered corporation is any publicly traded U.S. corporation on an established securities market. A specified affiliate is any: (a) corporation whose stock (by vote or value) is directly or indirectly owned by more than 50% by the covered corporation; or (b) partnership whose partnership interest or profits interest is directly or indirectly owned more than 50% by the covered corporation.

There are special rules for the acquisition of stock of an “applicable foreign corporation” and “surrogate foreign corporation.” An applicable foreign corporation is any foreign corporation whose stock is publicly traded on an established securities market. The 1% excise tax applies where a U.S. organized specified affiliate acquires the stock of the applicable foreign corporation. In this situation, the U.S. organized specified affiliate is treated as a covered corporation and pays the 1% excise tax on the applicable foreign corporation stock acquired by the U.S. organized specified affiliate. The value of the stock acquired by the specified affiliate is reduced by the value of the stock issued by the specified affiliate or stock issued to the employees of the specified affiliate. The adjustment does not apply to stock issued by the applicable foreign corporation. Similar rules apply to a surrogate foreign corporation, which is any domestic corporation or partnership that was acquired by a foreign corporation after September 20, 2021, subject to other special requirements set forth in Section 7874(a)(2)(B) of the Internal Revenue Code of 1986, as amended.

Observations Regarding the Excise Tax on Corporate Stock Repurchases

- A repurchase includes a redemption and any other economically similar transaction as determined by the Treasury. But there are exceptions for certain repurchases, such as: (a) a repurchase that is part of a tax-free reorganization and no gain or loss is recognized on the purchase by the shareholder “by reason of”

the reorganization; (b) repurchases followed by a contribution of the repurchased stock to an employee pension plan, employee stock ownership plan, or similar plan; (c) stock repurchases the total value of which does not exceed $1 million during the taxable year; (d) repurchases by a dealer in securities in the ordinary course of business; (e) repurchases by RICs or REITs; and (f) a repurchase that is treated as a dividend.

- A number of common and important restructuring transactions are not on the list of exceptions, including certain split-off transactions or a leveraged acquisition that involves a redemption. There is also an open question regarding how future regulatory guidance will interpret "economically similar," possibly broadening the number of corporate transactions that the excise tax applies to.

Clean Energy Tax Incentives

As noted above, one of the purposes of the Act is to advance a portion of the Biden Administration's economic agenda, in particular with respect to climate and clean energy initiatives. The Act accordingly targets $30.6 billion in tax credits to accelerate U.S. manufacturing of solar panels, in addition to batteries and critical minerals processing. These incentives aim to promote the U.S. production of solar cells, photovoltaic wafers, solar grade polysilicon, and polymeric back sheets.

The Act renews the production tax credit (PTC) for five years for facilities that begin construction before January 1, 2025. Without this renewal, the PTC had expired at the end of 2021. In addition to the existing eligible technologies of wind, biomass, municipal solid waste, geothermal, hydropower and marine and hydrokinetic energy, the PTC is revived for solar facilities and extends the PTC for geothermal facilities. To qualify for the full PTC, projects must comport with prevailing wage standards for workers in the area where the facility is located; if not, the PTC would drop to 20% of the full benefit.

For residential solar, the Act extends for 10 years the investment tax credit (ITC), including for solar products such as rooftop panels. Consumers could claim a tax credit of 30% of their solar costs until 2032. After that, the tax credit will drop to 26% in 2033, and 22% in 2034, respectively. Overall, the 30% tax credit could save homeowners on average $7,000 on a typical rooftop system. Home-use batteries connected to solar systems also would see tax incentives effectively reducing their costs by 30%, too. Beginning in 2023, the ITC includes an enhanced incentive for "environment justice solar facilities" located in a low-income community, on Native American land, or if the facility is installed on a residential building that participates in a covered federal housing assistance program.

For commercial solar, the Act raises the tax deduction for commercial building construction from $1.80 per square foot to up to $2.50 to $5.00 per square foot based on the energy efficiency and certain wage and apprenticeship requirements.

The Act additionally incentivizes consumers to invest in energy efficient and electric appliances and clean vehicles by providing $9 billion for rebate programs to electrify home appliances and consumer tax credits for used ($4,000 for lower and middle income individuals) and new clean energy vehicles ($7,500 for

individuals).

Finally, the Act extends (and in certain cases expands) a number of exiting tax incentives, including those relating to carbon capture facilities and credits for biodiesel and renewable and alternative fuels.

Observations Regarding the Clean Energy Tax Incentives

- One of the Act's purposes is to promote and maintain clean energy manufacturing in the U.S. across the supply chain of clean energy and transportation technologies. The PTC should promote these goals by providing incentives for constructing clean energy facilities.
- The clean energy incentives provide individual taxpayers with opportunities to either make or convert their homes, appliances, and cars to be energy efficient.

Increased IRS Funding

The Act additionally seeks to raise revenue through enhancing the resources of the IRS by making available approximately $80 billion of funding over the next 10 years, with approximately $45.6 billion appropriated for tax enforcement activities such as the determination and collection of taxes owed, legal and litigation support, conducting criminal investigations and providing digital asset monitoring and compliance activities.

Observations Regarding the Increased IRS Funding

- The increase of $45.6 billion to enforcement alone is significant. This amounts to an average-annual increase of $5 billion, which would double the IRS's enforcement budget. The Congressional Budget Office analysis anticipates that this provision will generate additional federal tax collections of $124 billion. Taxpayers should accordingly anticipate increased scrutiny by the IRS.

Carried Interest

As noted above, the carried interest provisions of the Act were ultimately removed from the legislative text. Had the provisions remained, they would have extended the three-year investment holding period to five years for taxpayers with adjusted gross income of $400,000 or more. In addition, the five-year period would not have started until the later of: (1) the date the fund acquired substantially all of its investments; or (2) the date when the fund manager acquired substantially of its carried interest. With this removal, the current carried interest provisions remain intact.

How HCVT Can Assist

HCVT can assist clients in a number of ways, including: 1) determining whether a company or group of companies would be subject to the Corporate AMT, and if so, assistance with calculating the Corporate AMT liability; 2) determining whether any of the clean energy tax incentives apply to a business or individual, and what their impact will mean; and 3) evaluating existing tax positions and whether a taxpayer should revisit or

bolster any positions in light of the IRS's increased enforcement initiatives.

HCVT Contacts

If you would like to discuss any of the above, please contact your HCVT relationship partner.