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New Corporate Minimum Tax and Stock Repurchase Tax Will Take Effect in 2023, but Questions Remain

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Key Points

- Whether a corporation is subject to the new 15% corporate alternative minimum tax may be difficult to determine in some cases, and there is unlikely to be much IRS guidance before the law comes into effect for taxable years beginning after December 31, 2022.
- Companies pursuing M&A transactions will need to consider carefully if and how a transaction could affect their liability for the new minimum tax.
- The broad definition of stock repurchase used in the new excise tax, which includes "redemptions," has implications for a wide range of transactions that do not involve conventional stock buyback programs, including de-SPACs and other M&A transactions.

The corporate alternative minimum tax (CAMT) and the excise tax on stock repurchases, each enacted as part of the Inflation Reduction Act of 2022, will soon become effective — for the CAMT, for taxable years beginning after December 31, 2022, and in the case of the stock repurchase excise tax, for repurchases occurring after that date. Both provisions establish novel tax regimes that will require expert tax guidance for affected companies to navigate successfully.

Corporate Alternative Minimum Tax

The CAMT generally requires corporations to pay at least a 15% minimum rate of U.S. federal income tax on their adjusted financial statement income (AFSI) if the corporation's controlled group averages over $1 billion in such income during any applicable prior three-year period. Many corporations will need to expend considerable time and expense to determine whether they are subject to the CAMT and, if so, how much additional tax they will owe, if any. Very little guidance from the Internal Revenue Service (IRS) is expected to be available before companies have to determine the CAMT's impact on their financial reporting, estimated tax payments, or transactions or investments closing in 2023.

Impact on M&A. The CAMT may require additional diligence and tax planning for M&A transactions because, once a corporation becomes subject to the CAMT, it generally remains so until certain conditions are met (including a determination from the IRS that the corporation should not continue to be subject to the CAMT). Buyers and sellers in the M&A market will need expert tax advice regarding the potential application of the CAMT or may find themselves unexpectedly bearing costly and complicated tax consequences.

Impact on partnerships (including LLCs classified as partnerships). Though entities classified as partnerships for U.S. federal income tax purposes, including many LLCs, are not themselves subject to the CAMT, they may nevertheless feel its impact. For CAMT purposes, a corporate partner in a partnership must determine its distributive share of the partnership's AFSI. A corporate investor entering into a partnership should ensure it has adequate contractual rights to obtain the information it needs to comply with the CAMT.

Impact on multinational corporations. U.S.-parented multinationals that may be subject to the CAMT may want to revisit their foreign corporate structures in light of the new law. The CAMT allows financial statement losses from pass-through entities to offset financial statement income in determining the U.S. group's AFSI and generally allows all foreign tax credits from pass-through entities to be claimed. Financial statement losses from controlled foreign corporations cannot offset financial statement income of the U.S. group, and the use of foreign tax credits generated by controlled foreign corporations is capped.

Foreign-parented multinationals with a U.S. taxable presence are not spared from the CAMT. U.S. corporate subsidiaries in a foreign-parented multinational group are subject to the CAMT if the group exceeds the $1 billion threshold and the U.S. corporate subsidiary averages $100 million or more in AFSI during the same three-year testing period.

Stock Repurchase Excise Tax

The stock repurchase excise tax consists of a 1% corporate-level tax on the fair market value of stock repurchased by publicly traded corporations (either directly or through certain subsidiary entities).

Uncertain and potentially broad scope. The excise tax applies to repurchases of stock by publicly traded corporations. It generally includes any "redemption" within the meaning of the U.S. tax code and any transaction the IRS determines to be "economically similar" to such a redemption. This definition's scope is far broader than the conventional stock buyback programs that appear to have been the intended target of the excise tax. Accordingly, publicly traded corporations will need to consider potential excise tax exposure for a wide range of transactions.

M&A transactions often include elements that are treated as "redemptions" for U.S. federal income tax purposes. For example, this "redemption" treatment can occur in a taxable transaction where some of the consideration paid to target shareholders is sourced from the target or from debt incurred or assumed by the target, or in a partially tax-free reorganization where "boot" *(i.e.*, cash or other nonstock consideration) is paid. Further, distributions by a corporation undergoing a liquidation and dissolution process could potentially be viewed as "repurchases," even though such distributions do not appear to raise the policy concerns underlying the new tax.

Absent IRS guidance to the contrary, the excise tax will also seemingly apply to redemptions by SPACs (such as in connection with a de-SPAC or an extension request), even if the SPAC was formed prior to the provision's enactment date. Redemptions of preferred stock with only limited equity features could also be taxed, even if the stock is redeemable pursuant to its terms and was issued prior to the enactment date.

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"Repurchase" exceptions. Certain transactions that otherwise constitute "repurchases" are explicitly excluded from the base of the excise tax, including a repurchase that is part of a reorganization (and in which no gain or loss is recognized on the repurchase by reason of the reorganization). This exception will require clarification in several respects, including its application to tax-free "split-off" transactions and to the payment of boot in acquisitive reorganizations and equity recapitalizations where the corporation may not be able to ascertain the amount of gain or loss recognized by particular shareholders.

Under another important exception, a repurchase is not subject to the excise tax in any case in which the repurchased stock (or other stock of equal value) is contributed to an employer-sponsored retirement plan, employee stock ownership plan or similar plan.

Netting of issuances against repurchases. The excise tax is applied to a net, rather than gross, measure of stock repurchases during each taxable year. To determine the net amount that is taxed in a given taxable year, the fair market value of stock issuances by a corporation during the year are generally netted against the fair market value of its stock repurchases during the year. Forthcoming IRS guidance is expected to address how to determine these values as well as whether tax-free stock dividends, stock splits and similar transactions should be credited as "issuances" for purposes of the netting rule. Public corporations will need to track stock issuances relative to repurchases to determine their excise tax liability.

(See also "Tax Enforcement: A Spotlight On Complex Partnership Structures.")