Sep 30, 2022

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Blogs
Tax Law Defined™ Blog

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Tax Planning Strategies Post-Inflation Reduction Act of 2022

On August 16, 2022, President Biden signed into law the Inflation Reduction Act of 2022 (the "Act").[1] In an effort to reduce deficits, invest in energy production, address climate change, and provide for healthcare subsidies, the Act makes several changes to the Internal Revenue Code that impacts several taxpayers. The Act, among other things, includes a 15% corporate alternative minimum tax, a 1% excise tax on stock buybacks, various credits for electric vehicles and green energy production, and increased Internal Revenue Service (IRS) funding. This article highlights some of the tax provisions included in the Act along with their impact on taxpayers.

Key Tax Provisions

15% Corporate Alternative Minimum Tax (AMT)

The Act proposed a 15% corporate AMT, which would apply to adjusted financial statement income for corporations with income in excess of $1 billion for a three-year period, effective for taxable years beginning on or after January 1, 2023.[2] The AMT is based in part on "book income" and targets corporations reporting substantial financial statement income but paying little or no U.S. income tax because of available deductions and credits.

1% Excise Tax on Repurchase of Corporate Stock

For tax years beginning on or after January 1, 2023, the Act imposes a nondeductible 1% excise tax on the fair market value of stock repurchased by publicly traded corporations.[3] The amount subject to the excise tax is generally the amount paid by an issuing corporation during the year to shareholders in exchange for their issuing corporation stock, reduced by the value of any stock issuances during the taxable year. A "repurchase" includes stock redemptions and economically similar transactions characterized as redemptions for federal income tax purposes.

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The exceptions to the excise tax include (1) repurchases of certain tax-free reorganizations (e.g., Section 355 divisive transactions) and repurchases of stock contributed to employee pension plans, (2) any new issues to the public, or stock issued to employees, would be deducted from the taxable amount, and (3) repurchases below $1 million or those contributed to employee pension plans (or similar plans) would not be subject to tax.

Extension of the Excess Business Loss Limitation to 2028

The Act extends the ability for noncorporate taxpayers to deduct business losses exceeding an indexed-for-inflation amount. For the tax year ending 2022, the amounts are $270,000 for single filers and $540,000 for joint filers. Losses that are in excess of these amounts are carried forward as net operating losses.[4] Previously, this limitation was set to expire after 2026, yet the Act extends the limitation through 2028. The extension of the excess business loss limitation was inserted into the Act instead of any extension to the $10,000 limitation on state and local tax deductions.

Increased IRS Enforcement

The Act attempts to "re-build" the IRS through increased funding and improvements in taxpayer compliance. The Inflation Reduction Act increases the IRS budget by roughly $80 billion over 10 years.[5] The money is broken into four main categories—enforcement, operations support, business system modernization, and taxpayer services—as well as a few other small items such as an exploratory study on the potential of a free-file system.

Tax Planning Strategies

Corporate AMT Planning Considerations for Section 355 Divisive Transactions

Under Section 355 of the Internal Revenue Code, a parent corporation may separate a subsidiary that conducts an active business into a distinct entity without the recognition of gain or loss by engaging in a distribution of a subsidiary stock in exchange for shares of the parent corporation (a "split-off"). Corporations use

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split-offs to achieve a variety of business purposes, including restructuring business objectives, streamlining management, separating growth strategies, and increasing shareholder value.

Under the Financial Accounting Standard Board's Accounting Standards Codification, a split-off transaction, where a subsidiary's stock is distributed in a non-pro-rata exchange for parent corporation stock, generally results in a gain for a parent corporation's financial statement purposes (generally measured by the excess of the fair market value of the subsidiary's stock over its book value).[6] This gain, when it comes to companies with at least $1 billion of "book income" would be subjected to the new 15% corporate AMT. Prior to the Act, a split-off was generally viewed by Congress as a tax-free corporate reorganization much like a "spin-off," which is unaffected by the corporate AMT as it does not result in gain for financial statement purposes.

Though stakeholders have asked the Treasury Department for guidance to treat otherwise tax-free split-offs as a tax-free spin-off, taxpayers that have been contemplating a "split-off" in 2023 would either need to revise their reorganization strategy or pay the additional 15% corporate AMT due to the Act.[7]

Excise Tax and Leveraged Buyouts

Leveraged buyouts ("LBOs") are the result of using a significant amount of borrowed funds (usually in the form of bonds or loans) to fund the cost of an acquisition. Due to these transactions almost always having a redemption component, certain aspects of an LBO may be subject to the 1% excise tax on repurchases. In the case of a single corporation LBO, a new corporation is formed by LBO sponsors, who obtain debt and equity financing prior to a merger with and into a target corporation. The funds delivered by a new corporation to the target corporation are distributed to the target's shareholders in exchange for all of the shareholder's stock. The ultimate transaction is treated as if the target obtained the debt financing and used those proceeds to redeem its stock from its shareholders.

As a result, taxpayers who plan to use special purpose acquisition companies ("SPACs") to repurchase company stock beginning on or

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after January 1, 2023, may be subject to the 1% excise tax. SPACs and their sponsors should therefore consider proactive steps to address any potential application of the 1% excise tax, including timing and structuring of LBOs, any required disclosures of risk factors, and contractual terms throughout the LBO to allow for payment.

To learn more about how provisions in the Inflation Reduction Act of 2022 could impact your business, please contact the author or any member of Frost Brown Todd's Tax practice group. You can also visit our Tax Law Defined Blog for more analysis on the latest trends and developments in state, local and federal tax administration.

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[1] H.R.5376 – 117th Congress (2021-2022): Inflation Reduction Act of 2022, H.R.5376, 117th Cong. (2022), http://www.congress.gov/.

[2] Inflation Reduction Act of 2022, H.R.5376, 117th Cong § 10101 (2022).

[3] Inflation Reduction Act of 2022, H.R.5376, 117th Cong § 10201 (2022).

[4] Inflation Reduction Act of 2022, H.R.5376, 117th Cong § 13903 (2022).

[5] Inflation Reduction Act of 2022, H.R.5376, 117th Cong § 10301 (2022).

[6] Financial Accounting Standard Board, Accounting Standards Codification paragraph 845-10-30-12, Nonmonetary Transactions.

[7] 176 Tax Notes Federal 1296 (AUG. 22, 2022).

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