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Tax Changes Under the Inflation Reduction Act—Impact on Health Care Organizations

Albert Lin (Husch Blackwell LLP)
Kevin Erb (Husch Blackwell LLP)

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The tax changes under the Inflation Reduction Act of 2022 (IRA), signed into law by President Biden on August 16, 2022, may have little effect on the typical health care organization. The primary change is the 15% corporate alternative minimum tax imposed on large corporations with average financial statement income exceeding $1 billion over a three-year period. It is estimated that only about 150 corporations are impacted by the corporate alternative minimum tax.

Regardless, health care organizations that are publicly traded (particularly in light of the special purpose acquisition company (SPAC) transactions that accelerated during the pandemic) should note that the IRA enacted a new Section 4501 of the Internal Revenue Code of 1986, as amended (Code), which imposes a non-deductible excise tax of 1% on the fair market value of stock of a "covered corporation" that is considered "repurchased" during the tax year. All taxpayers should also be aware of the considerable funding increase to the Internal Revenue Service (IRS), which, while largely earmarked for enforcement, may also help modernize the IRS and hopefully alleviate taxpayer frustrations in dealing with outdated technology and delayed processing times.

Changes would be effective January 1, 2023.

New Corporate AMT

"Applicable corporations" with average annual adjusted financial statement income (AFSI) exceeding $1 billion over a three-year period will be subject to an alternative minimum tax (AMT). The $1 billion threshold includes all entities treated as a single employer and is reduced to $100 million for a domestic entity that is part of an international financial reporting group with a foreign parent, if the combined average AFSI of the group exceeds $1 billion. If a corporation has been in existence for less than three years, average AFSI is determined with reference to the years the corporation has been in existence. A corporation can qualify as an "applicable corporation" beginning in tax years ending after December 31, 2021 (i.e., AFSI is measured for that year and the preceding two). The Department of Treasury is expected to issue regulations specifying how "applicable corporation" status may be lost, but until then, once a corporation qualifies as an "applicable corporation," the status will remain even if the $1 billion average threshold is no longer met.

An "applicable corporation" may be any corporation, excluding S corporations, regulated investment companies (such as mutual funds), and real estate investment trusts. Pending further guidance to the contrary, it is safe to assume that limited liability companies taxed as corporations would not avoid "applicable corporation" status (a rare circumstance given the high $1 billion threshold).

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If a corporation is an "applicable corporation," the AMT imposed would be at least 15% of the corporation's AFSI, assuming such AMT exceeds the corporation's regular income tax liability. An "applicable corporation" will be subject to AMT tax liability in years beginning after December 31, 2022.

The AFSI tax base for the AMT is largely based on pre-tax book, rather than tax, accounting. The IRA specifies that AFSI is determined based on a corporation's financial statements (the Applicable Financial Statement or AFS) prepared in accordance with GAAP or, if applicable, international financial reporting standards. The AFSI is adjusted, taking into account certain rules, as follows.

- For purposes of calculating tax liability, for a corporation that is a partner in a partnership, the corporation's AFSI includes only its distributive share of the partnership's AFSI. This differs from the rules for determining "applicable corporation" status, where, in certain scenarios, all AFSI of related entities is considered.
- A corporation includes its pro rata share of income or loss of controlled foreign corporations (CFCs) of which the corporation is a U.S. shareholder. A negative adjustment resulting from CFCs cannot be used and must be carried forward.
- The AFSI of any disregarded entities owned by a corporation are included in AFSI.
- Federal income taxes and foreign income taxes are disregarded in calculating AFSI.
- Income of tax-exempt entities owned by a corporation is disregarded to the extent such income is not classified as unrelated trade or business income (UTBI).
- Any depreciation expense taken into account on a corporation's AFS is disregarded and AFSI is reduced by deductions allowed under Section 167 in computing taxable income (i.e., tax depreciation replaces book depreciation).
- AFSI is reduced by Financial Statement Net Operating Losses, limited to the lesser of (i) 80% of AFSI (disregarding Financial Statement Net Operating Losses) or (ii) the aggregate amount of Financial Statement Net Operating Loss carryovers. A Financial Statement Net Operating Loss is a net loss on the corporation's AFS, after applying the AFSI adjustments, for tax years ending after December 31, 2019. A Financial Statement Net Operating Loss for any tax year may be carried over to each tax year following the tax year of the loss.

If foreign taxes are paid or accrued and recorded on a corporation's AFS, such corporation will receive a credit against its minimum tax. For foreign taxes paid by CFCs, a corporation may receive a credit for its pro rata share of foreign taxes paid by CFCs of which the corporation is a U.S. Shareholder, limited to 15% of the aggregate AFSI of such CFCs. Any excess over the 15% CFC limitation may be carried forward for five succeeding tax years.

For a domestic corporation, foreign taxes that are paid or accrued by such corporation and taken into account on the corporation's AFS are eligible for a credit. For such domestic corporations, there is no carryforward to the extent such amounts paid or accrued exceed current year AMT liability.

Corporations are able to claim a credit for the AMT paid in prior years in the event its regular tax liability exceeds that year's AMT liability; in essence, for profitable corporations that eventually have regular tax liabilities, the AMT tax is an acceleration of tax.

1% Excise Tax on Corporate Redemptions

Public health care organizations will be impacted by the new 1% excise tax, which will impact "covered" corporations as defined by new Section 4501 of the Code (compare this with the term "applicable corporation,"

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subject to the AMT, as defined in Section 59 of the Code, as amended). Any domestic corporation that has its stock traded on an established securities market is a “covered” corporation.

For “covered” corporations, new Section 4501 imposes a 1% non-deductible excise tax on the fair market value of stock repurchases, beginning on January 1, 2023. Stock “repurchases” may include foreign inversion transactions as well and IRS guidance will be forthcoming. Generally, the tax is intended to hit stock redemptions—where large companies repurchase stock to reward shareholders in lieu of dividends. The tax base is the amount the corporation pays to its shareholders in the repurchase, less the value of any stock issued by the corporation during the same year (so a repurchase followed by an issuance can lower the tax).

The excise tax would not apply to the following.

- Repurchases of stock that are taxed as dividends.
- Repurchases in connection with a tax-free reorganization, to the extent that no gain or loss is recognized by the shareholder by reason of the reorganization.
- Repurchases of stock that are subsequently contributed to employee retirement plans, employee stock ownership plans, or similar plans.
- Repurchases by regulated investment companies or real estate investment trusts.
- Repurchases that are less than $1M in aggregate value annually.
- Repurchases by dealers in the ordinary course of business.

Clean Energy Provisions

The significant subsidies and tax benefits relating to electric vehicles and renewable energy may also be of interest to health care organizations considering capital improvements and vehicle purchases. In particular, under new Section 6417 of the Code, certain tax-exempt and governmental entities may qualify for “direct pay” elections relating to energy tax credits whereby such tax-exempt entities can receive a cash refund for the amount of credits. Generally, these “applicable entities” include organizations exempt from federal income tax under Subtitle A (most Section 501(c) organizations), any state or political subdivision thereof, the Tennessee Valley Authority, an Indian tribal government, any Alaska Native Corporation, or rural electric cooperatives. It is unclear whether “agencies or instrumentalities” of such state and political subdivisions would qualify. Key potential credits would be available for the following:

- Wind, solar, geothermal, combined heat and power and other technologies.
- Electric charging stations.
- Carbon capture, clean hydrogen, investments in certain manufacturing facilities, clean vehicles, and clean fuel production.

Another potential benefit is that the Section 179D energy efficient building deduction is expanded to permit tax-exempt organizations to allocate the deduction attributable to such tax-exempt organization’s buildings to the designer of the building.

$79.6 Billion Allocation for IRS Funding

The IRS is receiving a major budget increase in the form of increased allocations, of which at least half of approximately $80 billion is for enhanced enforcement. However, the largest percentage increase is actually dedicated towards business systems modernization, which may alleviate backlogs and inefficiency caused by the antiquated systems currently in use.[1]

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With regard to enforcement, both Treasury Secretary Janet Yellen and IRS Commissioner Charles Rettig have stated that the additional enforcement will not target households that make under $400,000 a year.[2] Treasury Secretary Yellen has also stated that she hopes to work with the IRS on "creating new digital tools to allow taxpayers to get information from the IRS instantaneously and on improving taxpayer service, so the agency is well-equipped to answer calls when they come in."

Conclusion

The AMT provisions of the IRA are expected to impact roughly 150 corporations in the United States. Publicly traded corporations are impacted by the 1% excise tax (although, of course, individual and entity shareholders of such public healthcare organizations are indirectly impacted if such new tax will have a chilling impact on corporate redemptions). It remains to be seen what both the long-term and near-term impact of these "limited" tax increases will be. Organizations, both for-profit and nonprofit, may benefit from expanded clean energy incentives. And undoubtedly, the increased funding for modernization projects should help healthcare organizations avoid the all-too-common administrative headaches that result in wasted resources (for example, the matching of employer identification numbers with IRS records).

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[1] *See* Alex Muresianu, *How to Think About IRS Tax Enforcement Provisions in the Inflation Reduction Act*, Tax Found. (Aug. 17, 2022), https://taxfoundation.org/inflation-reduction-act-irs-funding/ for a table (*Table II: Contextualizing IRS Funding Increases*) showing the projected additional funding over ten years and the increase in what was previously budgeted for particular IRS areas.

[2] *See* https://home.treasury.gov/system/files/136/JLY-letter-to-Commissioner-Rettig-Signed.pdf and https://www.irs.gov/pub/irs-utl/commissioners-letter-to-the-senate.pdf.

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