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Dear Clients,

### The Inflation Reduction Act of 2022



The Inflation Reduction Act of 2022 has passed the House of Representatives and has been sent to the President for signature. This is a substantial piece of legislation including provisions that deal with the negotiation of drug prices by Medicare and with climate change.

The Legislation includes the following revenue-raising provisions:

#### **15% MINIMUM TAX ON LARGE CORPORATIONS**

This is similar to the provision proposed under the Build Back Better Act and imposes a tentative minimum tax of 15% of "adjusted financial statement income" (AFSI) for covered corporations with over \$1 billion in profits for any 3-year period ending prior to the current tax year. This provision would be effective for tax years beginning after December 31, 2022.

A covered corporation is a corporation whose stock is traded on an established securities market. This new minimum tax does not apply to S-corporations, regulated investment companies, or real estate investment trusts.

The deal made with Senator Kyrsten Sinema (D-AZ) modified the computation of AFSI to allow certain businesses to gain the benefit of accelerated tax depreciation. Manufacturers lobbied for this change, stating that the absence of such a provision would decrease incentives for investment and, consequently, harm U.S. manufacturing.

#### **CARRIED INTEREST LOOPHOLE**

To gain Senator Sinema's support for the bill, the section modifying the rules relating to carried interest has been eliminated. Senator Sinema has indicated that she will work with Senator Mark Warner (D-VA) to address the carried interest issues in a separate piece of legislation. Since such legislation would probably require 60 votes in the Senate, it is unlikely that this could be passed separately, even if the Senate remains evenly divided after the November election.

#### **1% EXCISE TAX ON STOCK REPURCHASES**

To compensate for the revenue loss due to the elimination of the carried interest provision, the final bill includes a 1% excise tax on stock buybacks. It is estimated that this provision will produce more revenue than the changes to the carried interest proposals. This excise tax will apply to repurchases of stock after December 31, 2022.

The excise tax will apply to redemptions of stock and to transactions determined by Treasury to be economically similar to a redemption. However, the law contains a number of exceptions, including: i) a repurchase which is part of a nontaxable reorganization; ii) repurchased stock (or stock of equal value) which is contributed to an employer-sponsored retirement plan or ESOP; iii) where the total value of the stock repurchased in a tax year does not exceed \$1 million; iv) a transaction allowed under regulations for repurchases by a dealer in securities in the ordinary course of business; v) repurchases by regulated investment companies or real estate investment trusts; vi) repurchases treated as a dividend for tax purposes.

#### **ADDITIONAL FUNDING FOR IRS ENFORCEMENT**

Funds are provided over a 10-year period to enhance taxpayer services; for enforcement; for operations and support; and for business systems modernization. Over 80,000 additional IRS personnel could be hired, which would double the Service's current workforce.

#### **EXTENSION OF THE LIMITATION ON NET BUSINESS LOSSES FOR INDIVIDUALS**

A last-minute change to the law includes an extension of the IRS sec 461(l) rules, which limit an individual's ability to use net operating losses for two additional years. This limitation, which was included as part of the Tax Cuts and Jobs Act, was scheduled to terminate in 2026. The limitation will now apply through 2028.

#### **MODIFICATION TO THE PAYROLL TAX R&D CREDIT**

Current law permits small businesses that may not have enough income tax liability to take advantage of their research and development credit to apply up to \$250,000 of the credit towards their social security payroll tax liability. To qualify, the small business must have less than \$5 million of gross receipts and be less than 5 years old.

The new law would permit an additional credit of up to \$250,000 to be applied against the Medicare payroll tax for tax years beginning after December 31, 2022.

#### **CLIMATE CHANGE TAX INCENTIVES**

The bill includes modifications to current credits and creates new tax credits to address climate change. These include credits for the purchase of new and used electric vehicles.

#### **WHAT IS NOT IN THE BILL**

Among the most notable items previously discussed in the Build Back Better Act that are missing from the Inflation Reduction Act of 2022 are the following:

1. No changes to the estate and gift tax rules.
2. No increases to the tax rates on high earners.
3. No change to the tax rates applicable to individuals on long-term capital gains.
4. No increase to the corporate income tax rate, which remains at a flat 21%.
5. No change to the qualified small business stock exclusion.
6. No change to the like-kind exchange rules.

**Once the Inflation Reduction Act is signed by the President, IRS and the Treasury will need to provide guidance for many of these changes, particularly with respect to tax credits. We will continue to monitor any clarifications issued.**

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