INTERNATIONAL TAX WEBINAR

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INFLATION REDUCTION ACT OF 2022: NEW STOCK BUYBACK EXCISE TAX

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Agenda

I. Explanation of New Stock Buyback Excise Tax

II. Application and Potential Issues

I. New Stock Buyback Excise Tax

- **Inflation Reduction Act of 2022**
  - The stock buyback excise tax was a late addition as a revenue raiser in the Inflation Reduction Act. It was added to get the support of the legislation from Democratic Senator Kyrsten Sinema (Democrat – Arizona) that was needed to pass the legislation. It was added in exchange for eliminating the proposal to extend the holding period for carried interest payments to private equity fund managers to qualify as long-term capital gains.
  - According to estimates from the U.S. Joint Committee on Taxation, the new tax is projected to raise $73 billion.

- **Policy Behind the Provision**
  - The main purpose of the provision is to raise revenue, but Congress also did not like that public companies were borrowing money to buy back shares to increase stock price of such shares while getting cash into the hands of the company's shareholders. Congress is hoping to incentivize public companies to reinvest cash into companies.
  - In addition, the net income of a U.S. corporation generally is taxed at a current U.S. federal income tax rate of 21% (plus state and local income taxes) and, if distributed to the company's shareholders would be taxed again to its shareholders. Redemptions of shares may be taxed at reduced long-term capital gains tax rates (23.8% for U.S. shareholders) and are taxed only to the extent that the redemption price exceeds the U.S. tax basis in such shares.

I. New Stock Buyback Excise Tax (cont'd)

- **Details of the Provision: New Section 4501 of the U.S. Internal Revenue Code**
  - Excise tax equals 1% of the fair market value of any stock of a covered corporation, the shares of which are publicly traded, which is repurchased by such corporation during the taxable year.
  - Effective for repurchases after December 31, 2022.
  - Covered corporation is a U.S. corporation the stock of which is traded on an established securities market
    - An established securities market includes — A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) (e.g., the New York Stock Exchange);
    - A national securities exchange exempt from registration under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) because of the limited volume of transactions;
    - A foreign securities exchange that, under the law of the jurisdiction where it is organized, satisfies regulatory requirements that are analogous to the regulatory requirements under the Securities Exchange Act of 1934 described in paragraph (b)(1) or (2) of this section (such as the London International Financial Futures Exchange; the Marche a Terme International de France; the International Stock Exchange of the United Kingdom and the Republic of Ireland, Limited; the Frankfurt Stock Exchange; and the Tokyo Stock Exchange);
    - A regional or local exchange; and
    - An interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise (e.g., NASDAQ).

I. New Stock Buyback Excise Tax (cont'd)

- **Repurchase**
  - A redemption for tax purposes (disproportionate distribution).
  - Any transaction determined by the Secretary to be an economically similar transaction.

- **Covers Purchases by Specified Affiliates**
  - A specified affiliate is any corporation in which more than 50% of the stock is owned (by vote or by value), directly or indirectly, by the covered corporation; and
  - any partnership in which more than 50% of the capital interests or profits interests is held, directly or indirectly, by such corporation.

I. New Stock Buyback Excise Tax (cont'd)

- **Important Adjustment**
  - The amount taken into account in calculating the tax on any stock repurchased is reduced by the fair market value of any stock issued by the covered corporation during the taxable year ("netting").
  - Includes the fair market value of any stock issued or provided to employees of such covered corporation or employees of a specified affiliate of such covered corporation during the taxable year, whether such stock is issued or provided in response to the exercise of an option to purchase such stock.

II. Application and Potential Issues

- **Application to Repurchase of Stock of a Non-U.S. Corporation**
  - In general, an acquisition of a stock of a public foreign corporation by a specified affiliate of such corporation is treated as repurchase of stock of a covered corporation by such covered corporation.
  - "Surrogate foreign corporation" (an expatriated entity) is treated as a covered corporation, but only stock issued to employees of the expatriated entity is counted for purposes of the adjustment for stock issued during the year.

II. Application and Potential Issues (cont'd)

- **Exceptions**
  - To the extent that the repurchase is part of a reorganization (within the meaning of section 368(a)) and no gain or loss is recognized on such repurchase by the shareholder by reason of such reorganization;
  - in any case in which the stock repurchased is, or an amount of stock equal to the value of the stock repurchased is, contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan;
  - in any case in which the total value of the stock repurchased during the taxable year does not exceed $1,000,000;
  - under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business;
  - to repurchases by a regulated investment company (as defined in section 851) or a real estate investment trust; or
  - to the extent that the repurchase is treated as a dividend for U.S. federal income tax purposes.

II. Application and Potential Issues (cont'd)

- **Future U.S. Treasury Regulations and Guidance**
  - The Secretary of the U.S. Treasury will prescribe regulations and other guidance as are necessary or appropriate to carry out, and to prevent the avoidance of, the purposes of this section, including regulations and other guidance:
    - to prevent the abuse of the exceptions provided;
    - to address special classes of stock and preferred stock; and
    - for the application of the special rules for acquisition of stock of certain foreign corporations.

II. Application and Potential Issues (cont'd)

- **Potential Issues**
  - Redemption of Preferred Stock.
  - Redemptions by SPACs.
  - Liquidations.
  - Disproportionate distributions that do not qualify as dividends for U.S. tax purposes.
  - Stocks with scheduled redemptions that existed before the enactment of the provision.
  - The calculation of the adjustment amount for stock issuances before January 1, 2023, for companies with fiscal tax years that end other than on December 31st.
  - Are payments under convertible debt or equity-linked debt instruments "economically similar"?
  - Are redemptions of "distressed debt" economically similar?
  - Amounts in reorganizations that are taxable redemptions, such as boot in a Section 351 transaction.
  - Cash in lieu of fractional shares.
  - Cash funded by the target and treated as a redemption.

II. Application and Potential Issues (cont’d)

- **Potential Issues**
  - Section 304 deemed dividends treated as redemptions.
  - Tax-free split offs treated as a redemption.
  - Partial liquidations treated as a redemption.
  - Transactions that straddle two taxable years.

CORPORATE ALTERNATIVE MINIMUM TAX

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I. Explanation of the Corporate Alternative Minimum Tax

II. Interplay with Global Minimum Tax under Pillar 2

I. Corporate Alternative Minimum Tax

- The provision creates a 15% alternative minimum tax (CAMT) for “applicable corporations.”
  - There are between 125 and 150 companies that will be subject to the tax.
  - The tax is estimated to raise $222 billion.
  - The provision is effective for taxable years beginning after 12/31/22.
- What is an Applicable Corporation?
- What is Adjusted Financial Statement Income?
- How is the tax computed?

I. What is an Applicable Corporation?

- Applicable corporations are corporations with more than $1 billion of average adjusted financial statement income (AFSI) over a 3-year period (or less if the company has been in existence less than 3 years).
  - All persons treated as a single employer under Section 52 are aggregated in making this determination.
  - The $1 billion figure is not adjusted for inflation.
- The corporate AMT does not apply to S corporations, regulated investments companies (RICs), and real estate investment trusts (REITS).
- Applicable corporation status is measured at the end of the preceding year, rather than the current year.
  - Example: A corporation's status in 2023 is based on the test in 2022.
- Once a corporation is an applicable corporation, that status generally is maintained, subject to some change in ownership provisions.

I. What is an Applicable Corporation (cont'd)

- For foreign-parented corporations:
  - A corporation that is a member of a foreign-parented multinational group meets the AFSI test for a tax year if:
    - The average annual AFSI of the corporation for the three-year period ending with such year, inclusive of the AFSI of all foreign members of the International Financial Reporting Group, exceeds $1 billion; and
    - The corporation's average annual AFSI for the same three-year period, exclusive of the AFSI of such foreign members, is at least $100 million

I. What is Adjusted Financial Statement Income?

- The tax is measured based on financial statement income, so that it applies to taxpayers that have book income but pay no federal income tax.
- There are several adjustments to financial statement income
  - Pension income and expense that would be included in financial statement income is excluded.
  - Depreciation that is taken for tax purposes is allowed.
  - Taxes are not deducted.
- Many of the complexities that are arising are based on the fact that the tax is based on financial statement income.
  - Sales of consolidated subsidiaries will typically result in asset basis steps for GAAP, but not for tax.
  - What should happen on a subsequent sale?
- There is broad regulatory authority to resolve complexities.
  - There are 17 specific grants of regulatory authority.

I. How is the Tax Computed?

- An applicable corporation's corporate AMT is:

  Corporate AMT= Tentative Minimum Tax minus Regular Tax plus any BEAT tax.

- An applicable corporation's Tentative Minimum Tax (TMT) is:

  Tentative Minimum Tax = AFSI- times 15% minus foreign tax credit.

  Relatively lenient rules apply for determining the foreign tax credit.

- General Business Credits, including R&D and renewable energy credits, may generally offset up to approximately 75% of the sum of a corporation's regular tax and AMT.
- A corporation is eligible to claim a credit against regular tax (plus any BEAT) for corporate AMT paid in prior years.

II. Interplay With Global Minimum Tax Under Pillar Two

A. Background

- The Pillar Two Model, released on December 20, 2021, is part of the Two-Pillar Solution to address the tax challenges of the digitalization of the economy that was agreed upon by 137 member jurisdictions of the OECD/G20 Inclusive Framework on BEPS and endorsed by the G20 Finance Ministers and Leaders in October.
    - Legislation is needed in the U.S. to adopt the provisions of Pillar Two.
- Taxpayers that have EUR 750 million or more in consolidated revenues are in scope of the Model Rules.
- Taxpayers in scope of the rules calculate their effective tax rate for each jurisdiction where they operate and pay top-up tax for the difference between their effective tax rate per jurisdiction and the 15% minimum rate.
- Any resulting top-up tax is generally charged in the jurisdiction of the ultimate parent of the multinational enterprise.

II. Interplay With Global Minimum Tax Under Pillar Two (cont'd)

B. Interplay with Pillar Two

- There are significant base differences and other provisions between the CAMT and the Global Minimum Tax.
- Even though the tax rates are the same, the U.S. Corporate Minimum Tax is not a good IIR.
  - Impact: A U.S.-parented multinational enterprise that pays the corporate minimum tax likely has increased its adjusted covered taxes and thereby its effective tax percentage for Pillar Two and therefore will reduce the likelihood of the application of the undertaxed payment rule to its U.S. operations.

INFLATION REDUCTION ACT OF 2022: CLIMATE TAX INCENTIVES

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Agenda

I. Explanation of Key Climate Provisions

II. Market Questions

Significance of the IRA

- Expands opportunities for renewable projects to qualify for tax credits.
  - Extends timing for PTC and ITC projects – at least another ten years.
  - Decreases pressure on beginning construction.
  - New ITC for stand-alone storage.
  - Other extensions and changes (e.g., expansion of carbon sequestration credit, new clean hydrogen PTC, expansion of electric vehicle credit).
- Provides for more flexibility in monetizing the credits.
  - New direct pay and transferability concepts.
  - Wind and solar can now elect PTC or ITC.
- Introduces new social policy provisions.
  - New labor requirements – prevailing wage and apprenticeship.
  - New adders for domestic content, energy communities, and low-income communities.

Prevailing Wage and Apprenticeship Overview

- Projects that qualify for tax credits automatically get a "base rate."
- Projects can get an "increased rate" worth five times the base rate if prevailing wage and apprenticeship requirements are met. Certain projects are exempt.
  - Prevailing wage = Wages at prevailing rates for similar work at the project location as determined by the Department of Labor.
    - Applies to laborers and mechanics during construction and the applicable tax credit period.
  - Apprenticeship = Minimum percentage of total labor hours to construct facility are performed by "qualified apprentices" who participate in a registered apprenticeship program that complies with certain federal requirements.
    - Percentage is 10% for 2022, 12.5% for 2023, and 15% after 2023.
- Exempt projects:
  - Began construction before passage of Treasury guidance on apprenticeship/prevailing wage + 60 days.
  - Less than 1 MW (AC) projects.

Tax Credit Adders Overview

- Domestic Content
  - Up to 10% adder for PTC or ITC.
  - Requires threshold percentage of steel (100%), iron (100%) and "manufactured product" (generally 40-55%) which is a component of a project to be produced in the U.S.
- Energy Community
  - Up to 10% adder for PTC or ITC.
  - Energy communities:
    - Brownfield Sites.
    - Areas with employment or tax revenues relating to coal, oil, or natural gas and above average unemployment.
    - Areas in which a coal mine or a coal-fired electric generating plant has closed.
- Low-Income Community
  - Up to 20% adder to the ITC for solar and wind projects located in certain low-income communities, low-income residential building projects, or on Indian land.
  - Limited to projects under 5 MW (AC).
  - Dependent on receiving "environmental justice" capacity allocation from Treasury.

Direct Pay and Transferability Overview

- Direct Pay
  - Allows taxpayers to receive cash value of the tax credits in the form of a tax refund from the IRS.
  - Avoids need to have sufficient tax liability to take advantage of the credit.
  - Mostly limited to certain tax-exempt entities (including municipalities and state and local governments).
  - Taxable entities can elect direct pay for a limited subset of credits: carbon sequestration, hydrogen production, and advanced manufacturing.
- Transferability
  - Allows taxpayer to sell tax credits outright to an unrelated person for cash.
  - As with direct pay, avoids need to have sufficient tax liability to take advantage of the credit.
  - New concept, so limited market precedent.

PTC Overview

- Unreduced base/increased PTC rates apply to projects that place in service in 2022 or later.
  - Projects that are already in service are stuck with existing phasedown schedule.
- PTC projects are eligible for adders beginning in 2023.
- Solar is newly eligible for PTCs.
- Section 45 PTC replaced by 45Y PTC in 2025.
  - Electricity may be sold, consumed or stored by a related person if facility is equipped with a metering device owned and operated by an unrelated person.
  - Facility must have a zero-greenhouse gas emissions rate.
- New 45Y PTC starts phasing down for projects that start construction two years after the later of (i) the calendar year in which the Secretary of the Treasury Department determines that annual greenhouse gas emissions from the production of electricity in the US are 25% or less than 2022 levels, or (ii) 2032.

ITC Overview

- Unreduced base/increased ITC rates apply to projects that place in service in 2022 or later.
  - Projects that are already in service are stuck with existing phasedown schedule.
- ITC projects are eligible for adders beginning in 2023.
- New ITC for stand-alone storage facilities (i.e., regardless of whether charging is from a solar project).
- New ITC for biogas property.
- Section 48 ITC replaced by 48E ITC in 2025.
  - Facility must have a zero-greenhouse gas emissions rate.
- New 48D ITC starts phasing down for projects that start construction two years after the later of (i) the calendar year in which the Secretary of the Treasury Department determines that annual greenhouse gas emissions from the production of electricity in the US are 25% or less than 2022 levels, or (ii) 2032.

Carbon Capture and Sequestration Overview

- The IRA would both extend the existing credit for projects that begin construction before 2033 and increase the credit value as illustrated below.

End Use	Current Law	Base	Increased Credit
Traditional Carbon Capture Carbon Oxide Used or Utilized	$35	$12	$60
Carbon Oxide Sequestrated	$50	$17	$85
Direct Air Capture Carbon Oxide Used or Utilized	$35	$26	$130
Carbon Oxide Sequestrated	$50	$36	$180

- Minimum CO2 capture requirements are eased, broadening the number of facilities that should be able to install carbon capture equipment and claim 45Q tax credits.

Hydrogen Overview

- New tax credit for hydrogen; value phases down depending on how much CO_2 remains after the hydrogen production process.

CO2 Per KG of H2 Remaining After Removal	PTC Credit Percentage	PTC Value	ITC Value
Not greater than 4 kg and less than 2.5 kg	20%	$.60	1.2%
Less than 2.5 kg and not less than 1.5 kg	25%	$.75	1.5%
Less than 1.5 kg and not less than .45 kg	33.4%	$1.00	2%
Less than .45 kg	100%	$3.00	6%

- Option to claim ITC in lieu of PTC.
- IRA facilitates the pairing of hydrogen facilities with wind and solar farms for which PTCs may be claimed by relaxing a PTC rule barring sales between related parties. This opens the door to common ownership of both facilities.

Market Questions

1. What will the market for tax credit purchases look like?
2. How will the timing of direct pay or transferred tax credit benefits compare to traditional tax equity?
3. To what extent can I currently confirm a project gets an energy community adder?
4. How is the financing market reacting to uncertainty generally?

UK: Recent Tax Developments

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Topics

- Round-up of recent developments
- UK holding company regime
- OTS call for evidence on remote and distance working
- QAHC regime
- Possible future developments

Recent Fiscal Statements

<u>Brief overview of recent events</u>

- **23 September 2022**: Growth Plan ("Mini-Budget"): announcement of a series of wide-ranging tax-cutting measures
- **17 October 2022**: "Fiscal Statement": reversal of many of the key Growth Plan announcements
- **31 October 2022**: further fiscal announcements expected, but delayed to **17 November 2022**

Recent Fiscal Statements

Current status of key points following these announcements

- **UK corporation tax rate**: to increase from 19% to 25% from 1 April 2023 (as had previously been announced at Budget 2021).
- **Income tax**: currently, no new announced changes to the rates (but may soon increase).
- **Energy Profits Levy (“windfall tax”)**: currently, no changes to the Energy Profits Levy that was introduced in May 2022.
- **NICs / Health and Social Care Levy**: reversal of the temporary 1.25% increase in NICs rates from November 2022, and cancellation of the previously announced new Health and Social Care Levy.
- **Capital Allowances**: Annual Investment Allowance (which provides 100% relief on certain qualifying expenditure on plant and machinery) to remain at £1m, rather than dropping to £200k as previously announced.
- **SDLT**: increase in the nil-rate threshold from £125k to £250k (and from £300k to £425k for first time buyers).
- **EIS / VCT**: to be extended beyond 2025, notwithstanding the previously announced ‘sunset clause’.
- **SEIS**: certain limits to be increased, to make the regime more generous.

UK Holding Company Regime

<u>UK holding company regime</u>

- UK remains an attractive holding company jurisdiction:
  - no changes to the following key areas:
    - participation exemption
    - no WHT on dividends paid by UK resident companies
    - wide DTT network
    - QAHC regime
  - increase of UK corporation tax rate from 19% to 25% from 1 April 2023 is not generally expected to impact the attractiveness of the UK as a holding company jurisdiction.

Call for Evidence on Hybrid and Distance Working

OTS call for evidence

- Office of Tax Simplification ("OTS") call for evidence, looking at the suitability of the UK tax rules in light of increased hybrid and remote working in recent years.

- Orrick has provided submissions on two key areas:
  - Corporate tax residence
  - Employer of record (EoR) arrangements

- We have engaged with the OTS and made proposals to simplify the rules, to facilitate cross-border expansion of business from and to the UK.

The UK's Qualifying Asset Holding Company (QAHC) Regime

<u>Some key benefits</u>

- Exemption from corporation tax on disposal of shares (provided shares do not derive more than 75% of their market value from UK land)
- Exemption from corporation tax on profits from an overseas property business (provided such profits are subject to tax abroad)
- Payments of interest by QAHCs exempt from UK WHT
- Allowance for deductions for certain interest payments that would otherwise be disallowed
- Share buy-backs by QAHCs from individuals generally treated for tax purposes as capital rather than income in individuals' hands, and therefore subject to capital gains tax rates rather than income tax rates
- Exemption from stamp duty / stamp duty reserve tax on repurchase of own shares and loan capital
- Favourable treatment for non-UK domiciled individuals

QAHC Regime – Overview of Qualifying Conditions

- Company
  - Must be UK tax resident and not a REIT
  - Must be unlisted
- Investment strategy must not involve
  - Acquisition of equity securities that are listed or traded on a recognised stock exchange or any other public market or exchange, except for purpose of facilitating change of control
  - Other interests that derive their value from such securities
- Main activity of company must be the carrying on of an investment business; any other activities must be ancillary and not carried on to any substantial extent
- At least 70% of the voting rights / entitlement to profits and/or assets of company must be held by qualifying investors – includes certain types of diversely held fund; public authorities; long-term insurance businesses; pension schemes

Expectations from forthcoming 17 November statement

- Tax rises anticipated across the board
- Further windfall taxes on energy companies (in addition to existing Energy Profits Levy) possible
- Personal tax rates expected to be affected
  - Income tax
  - National Insurance (social security)
  - Capital gains tax?
- Corporation tax rate already scheduled to rise from 19% to 25% as of April 2023

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