



Excise tax on repurchases of stock

Tax Alert

Overview

On August 7, 2022, the Senate passed the Inflation Reduction Act of 2022 (the "Act"). The Act includes an excise tax of 1 percent on repurchases of stock by certain publicly traded corporations (the "Excise Tax"). The Excise Tax in the Act generally is identical to the version that was included in the proposed Build Back Better Act from 2021. The House is expected to approve the Act on August 12, 2022, after which the Act would be signed into law by President Biden. The Excise Tax would be applicable to repurchases of stock beginning after December 31, 2022.

Proposal to tax the fair market value (FMV) of stock repurchased during a year by certain publicly traded corporations

In general

Section 10201 of the Act would introduce new section 4501, under new Chapter 37, to Subtitle D of the Internal Revenue Code.

Section 4501 would impose the Excise Tax equal to 1 percent of the FMV of stock of a covered corporation that is repurchased by such corporation after December 31, 2022, during any taxable year.

For this purpose, a covered corporation generally would mean any domestic corporation, the stock of which is traded on an established securities market. An established securities market is defined by reference to [section 7704\(b\)\(1\)](#), and includes the following:

- a national securities exchange that is registered under the Securities Exchange Act of 1934 (*e.g.*, NYSE and NASDAQ);
- a national securities exchange exempt from registration under the Securities Exchange Act of 1934 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 the first two categories;

- any 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.

Observation: Although to be a covered corporation, stock of the corporation must be publicly traded as described above, the Excise Tax appears to apply to repurchases of any stock of the covered corporation (e.g., preferred stock issued in a private offering).

Moreover, a covered corporation will also be subject to the Excise Tax where the stock of the covered corporation is acquired by one or more of its specified affiliates (other than intragroup transfers among the covered corporation and/or its specified affiliates) during the taxable year. A specified affiliate is: (i) any corporation more than 50 percent of the stock of which is owned (by vote or value), directly or indirectly, by the covered corporation and (ii) any partnership more than 50 percent of the capital or profits interests of which is held, directly or indirectly, by the covered corporation.

Observation: Although the statutory language does not specifically provide for any constructive ownership rules, the reference to “indirect” ownership could be one area where guidance is provided in future regulations.

Observation: While a majority-owned corporate subsidiary or partnership of a covered corporation may be a specified affiliate of the covered corporation, the reverse does not appear to be the case—that is, a corporation or partnership that is a majority shareholder of a covered corporation would not appear to be a specified affiliate of that covered corporation (i.e., subsidiaries with a separate public float).

Stock will be treated as repurchased only if it would constitute a “redemption” by the covered corporation within the meaning of [section 317\(b\)](#), or any transaction determined by the Secretary of the Treasury to be economically similar to a redemption under section 317(b).

A “redemption” is defined as an acquisition by a corporation of its own stock from a shareholder in exchange for “property,” and “property” is defined under section 317(a) to include money or any other property except for stock of such redeeming corporation or rights to acquire such stock.

Observation: Examples of a redemption under section 317(b) include open-market share repurchase programs, self-tender offers, and accelerated share repurchase transactions.

Redemptions may be a component in leveraged buyouts (i.e., acquisitions of public target corporation where the target corporation borrows or assumes the debt of a merger subsidiary and the proceeds are provided to target corporation shareholders). In addition, a [section 304](#) transaction involving a publicly traded acquiring corporation is treated as a redemption of stock of such acquiring corporation.

Observation: An example of a transaction that may not meet the definition under section 317(b) but could be viewed as economically similar is a partially taxable public acquisitions under [section 351](#) (e.g., a so-called double dummy transaction).

Exceptions

Section 4501 provides for the following exceptions—transactions that might otherwise be treated as repurchases but are not subject to the Excise Tax:

- To the extent that the repurchase is part of a [section 368\(a\)](#) reorganization and no gain or loss is recognized on such repurchase by the shareholder by reason of such reorganization;

Observation: The exception poses a number of interpretive questions regarding its scope and application, particularly with respect to reorganizations in which cash or other boot is issued as part of the consideration in the reorganization. See also the “Adjustments” discussion below for whether an adjustment may be allowed for shares issued by the acquiring corporation in the reorganization.

Observation: The exception also does not appear to cover other common public acquisition and divestiture structures, such as section 351 transfers and split-offs under [section 355](#) (although split-offs preceded by a section 368(a)(1)(D) reorganization may be covered by this exception).

- The repurchased stock (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;

Observation: The exception for repurchased stock that is contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan appears to be intended to cover broad-based retirement plans, but will need further guidance. In particular, the reference to “employer-sponsored retirement plan” does not appear to be limited to a plan qualified under [section 401\(a\)](#), and thus, it may include nonqualified retirement arrangements, such as a supplement employee retirement plan (SERP) or excess benefit plan.

However, the inclusion of SERPs and excess benefit plans, which are generally available to executives and other senior employees, within the meaning of an “employer-sponsored retirement plan” appears inconsistent with stated legislative intent.

Observation: Additionally, whether a “similar plan” includes an Employee Stock Purchase Plan (ESPP) is uncertain (see additional comments provided under the “Adjustments” section below). The definition of a “similar plan” may not include an ESPP, as contributions are generally not made by an employer into an ESPP. Instead, ESPP rights are treated as statutory options under [section 423](#). As noted below, it appears that stock issued pursuant to the exercise of a purchase right under an ESPP may be covered by the “Adjustment” provision of section 4501(c)(3) instead of an “Exception” under section 4501(e)(2). Characterizing the purchase of stock through an ESPP as an “Adjustment” rather than as an “Exception” may affect the calculation of the ultimate amount subject to the Excise Tax.

- The total value of stock repurchased during the taxable year is \$1 million or less;
- Under regulations prescribed by the Secretary of the Treasury, a repurchase by a dealer in securities in the ordinary course of business;
- Repurchases by regulated investment companies (RICs) or real estate investment trusts (REITs); and
- To the extent the repurchase is treated as a dividend for purposes of the Code.

Observation: This exception appears applicable to acquisitions of stock that meet the definition of a redemption in section 317(b) but fail to qualify for sale or exchange treatment under [section 302\(a\)](#). The exception appears further limited to the amount of the redemption that is taxable as a dividend under [section 316](#) (i.e., only up to the allocable earnings and profits of the covered corporation). Note, however, distributions directly

taxable under [section 301](#) are not subject to the Excise Tax, regardless of whether they taxable dividends under section 316 or not.

Adjustments

For purposes of calculating the Excise Tax, the FMV of the repurchased stock during the taxable year would be reduced by the FMV of any stock issued by the covered corporation during the taxable year.

Observation: Stock issued by the covered corporation during the taxable year may include stock issued in a traditional primary public offering, stock issued as compensation to employees (as noted below), as well as stock issued to acquire property, including stock issued in mergers and acquisitions.

Issued stock would include the FMV of stock issued or provided to employees of the covered corporation or employees of a specified affiliate of the covered corporation, and would be included regardless of whether such stock was issued or provided in response to the exercise of an option to purchase such stock.

Observation: The proposal does not define whether or when stock is treated as “issued” or “provided” to an employee but further guidance may clarify. Each type of equity-based incentive award will need to be analyzed to assess when stock is issued or provided to an employee. For example, whether restricted stock subject to vesting may be treated as issued upon the grant of restricted stock to an employee regardless of whether a [section 83\(b\)](#) election is made or only when such stock vests. The timing may matter as the value of the stock may change significantly between the grant date and the vesting date. It also appears that shares transferred pursuant to the exercise of stock options and in settlement of vested restricted stock units (RSUs) may be considered “issued” when the respective option exercise or initiation of share delivery occurs. Further, the transfer of shares pursuant to the exercise of an incentive stock option (ISO) that meets the requirements of [section 422](#) or exercise of a purchase right under an ESPP that meets the requirements of section 423 may be considered “issued” regardless of the fact that the employee may not be subject to income tax on the exercise.

Observation: It also does not appear that any potential excess adjustment that might exist in any given taxable year could be carried forward, or whether any potential adjustment may be succeeded to by another corporation (*e.g.*, the covered corporation is acquired pursuant to a merger).

Foreign corporations and surrogate foreign corporations

If stock of an applicable foreign corporation is repurchased by either (i) a domestic specified affiliate or (ii) a foreign partnership with a domestic entity partner (other than intragroup transfers among the applicable foreign corporation and/or its specified affiliates), such specified affiliate is treated as though it were a covered corporation, and the acquired stock were stock of such covered corporation.

An applicable foreign corporation would mean any foreign corporation the stock of which is traded on an established securities market (described above).

Any adjustment allowable for the FMV of stock issued during the taxable year would only apply with respect to stock issued or provided by the relevant specified affiliate to its employees.

Observation: If the specified affiliate is a foreign partnership with one or more partners that are domestic entities, the proposed language does not specify how the adjustment may be computed and whether it might be reduced in some proportion to the partners that are domestic entities. The proposed language also does not specify whether repurchases by foreign subsidiaries of domestic specified affiliates of an applicable foreign corporation may be subject to the Excise Tax.

If stock of a covered surrogate foreign corporation is repurchased by such covered surrogate foreign corporation or a specified affiliate, the corresponding expatriated entity would be treated as a covered corporation, and all repurchases of stock of the covered surrogate foreign corporation would be treated as made by the expatriated entity.

A covered surrogate foreign corporation would mean any “surrogate foreign corporation” (as determined under [section 7874\(a\)\(2\)\(B\)](#) and using September 20, 2021), the stock of which is traded on an established securities market (described above), but only for the applicable period under section 7874(d)(1) (*i.e.*, 10 years).

An expatriated entity would have the meaning set forth in section 7874(a)(2)(A) (*i.e.*, the acquired domestic corporation or partnership relating to the surrogate foreign corporation, and any U.S. person who is related (within the meaning of [section 267\(b\)](#) or [707\(b\)\(1\)](#)) to such domestic corporation or partnership).

The adjustments allowable for the FMV of stock issued during the taxable year would apply only to stock issued or provided by the expatriated entity to its employees.

Observation: Although the statutory text does not explicitly provide for an intragroup transfer exemption for transfers of stock of the covered foreign surrogate corporation, as is the case for covered corporations and applicable foreign corporations, presumably such intragroup transfers are intended to be excluded.

Effective date and regulatory authority

The Secretary of the Treasury can prescribe regulations (and other guidance) that is necessary and appropriate to carry out, and to prevent the avoidance of, the purposes of the Excise Tax, including:

- To prevent the abuse of the statutorily listed exceptions;
- To address special classes of stock and preferred stock; and
- For the application of rules to foreign corporations.

The Excise Tax would not be deductible in computing U.S. federal income tax.

The Excise Tax would apply to repurchases beginning after December 31, 2022.

Observation: For fiscal year taxpayers, additional guidance may be required as to whether stock issuances that occur in their taxable year that begins before but includes December 31, 2022, may be permitted as adjustments to the Excise Tax for stock buybacks that occur after December 31, 2022, in that taxable year.



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