



§ 4501: Stock Buyback Excise Tax

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Agenda

Background

Covered Corporations

Repurchases

Calculating the Tax & Exceptions

Questions

Background

- The Inflation Reduction Act (2022) introduced a 1% excise tax on stock buybacks (Code § 4501)
 - Applicable to repurchases of stock after December 31, 2022
- In Notice 2023-2 (Dec. 27, 2022), Treasury issued preliminary guidance on stock buybacks
 - Netting rule
 - Tax-free reorganizations
 - What is/isn't a repurchase
 - Timing and valuation rules

What is the Stock Buyback Excise Tax?

- Code § 4501(a) imposes 1% excise tax on the fair market value of any stock “repurchased” by a “covered corporation”
 - Non-deductible
 - Reduced by “netting” rules
 - Qualifying property exception
 - New issuances
 - Dividend exception
 - “Stock” applies to publicly and non-publicly traded stock
- Applies only if annual repurchases > \$1,000,000
 - Determined before application of netting rule or statutory exceptions

Covered Corporations

- A “covered corporation” is any domestic corporation whose stock is traded on an “established securities market”
 - Established securities market is a foreign or domestic securities exchange. Treas. Reg. § 1.7704-1(b)
 - Similar treatment for “surrogate” (expatriated) foreign corporations
- Also includes “specified affiliate” that purchases stock of a covered corporation (deemed repurchase)
 - Specified affiliate: any corporation or partnership in which the covered corporation directly or indirectly owns > 50% (vote or value, profits or capital interests)

Covered Corporations (Cont'd)

- Applies to “applicable foreign corporation” if stock purchased by a specified affiliate that is a domestic corporation, a domestic partnership, or a foreign partnership with a domestic partner
 - Domestic partner: indirect or direct
 - Applicable foreign corporation is any foreign corporation traded on an established securities market (same as domestic “covered corporation”)
- If applicable:
 - Specified affiliate is treated as a covered corporation
 - Strict netting: only permits netting to the extent of employee issuances to specified affiliate
- Also applies to acquisitions funded by specified affiliates with the principal purpose of avoiding tax (including distributions, debt, or capital contributions)
 - *Per se* rule: funded entity (including applicable foreign corporation) repurchases stock within two years of funding by specified affiliated (excluding distributions)

Repurchases

- Code § 4501(c)(1): a repurchase is a § 317(b) redemption or an economically similar transaction
- Notice 2023-2 provides guidance on what constitutes an economically similar transaction:
 - Exclusive list of transactions that are § 317(b) redemptions but not repurchases
 - Exclusive list of transactions that are economically similar
 - Non-exclusive list of not economically similar transactions

Repurchases: § 317(b) NOT Repurchase

- Exclusive list
- § 304(a)(1) transactions (acquisitions between related corporations)
- Rounding: payment of cash in lieu of fractional shares if
 - §§ 368 or 355 apply or pursuant to a settlement of an option or other instrument;
 - “Mere rounding” (cash received is not separately bargained);
 - Payment is carried out solely for administrative convenience; and
 - Amount of cash \leq one full share of stock

Repurchases: Economically Similar

- Exclusive list
- Acquisitive reorganizations (target corporation)
 - A reorgs
 - C reorgs
 - Forward or reverse triangular mergers
- E reorganizations (capitalizing corporation)
- F reorganizations (target corporation)
- Split-offs
 - Shareholders exchange distributing corporation stock for a controlled corporation's stock in a § 355 transaction
- Liquidations to which both §§ 331 and 332 apply
 - § 331 distribution is a repurchase
 - § 332(a) is not a repurchase

Repurchases: Not Economically Similar

- Non-exclusive list
- Distributions in complete liquidation and dissolution under §§ 331 or 332(a)
 - Must occur within the taxable year
- Divisive transactions under § 355 other than split-offs
 - E.g., spin-offs

General Takeaways So Far

- Reach is broad
 - Foreign and domestic corporations
 - Traded on foreign or domestic stock exchanges
 - Stock subject to buyback does not need to be publicly traded
 - Funded repurchases
- Does not apply to
 - Non-publicly traded corporations
 - Non-publicly traded subsidiary stock
 - Foreign corporation stock purchased by foreign specified affiliates
- Applies to tax-free reorganizations --- but have no fear!

Calculating the Tax

- Excise Tax = 1% * (Repurchased Stock – Qualifying Property – Issuances – Dividend Exception)
 - Qualifying property: tax-free reorganizations less boot
 - Certain issuances of stock
 - Repurchase treated as a dividend
- Note: many exceptions do not apply to the specified affiliate of an applicable foreign corporation

Netting Rules: Qualifying Property

- Excise Tax = 1% * (Repurchased Stock – **Qualifying Property** – Issuances – Dividend Exception)
- Property to the extent that no gain or loss is recognized under §§ 354 or 355
 - Includes economically similar transactions (acquisitive reorg, E reorg, F reorg, split-off)
 - See Example 6 in Notice 2023-2 (FMV 100x, A reorg, 60x stock, 40x boot)
- Stock contributed to an employer-sponsored retirement plan
 - Same or different class
 - Currently only applies to plans qualified under § 401(a) but Treasury is seeking comments on expanding to non-qualified plans

Netting Rules: Issuances

- Excise Tax = 1% * (Repurchased Stock – Qualifying Property – **Issuances** – Dividend Exception)
- Issued to employees, including employees of a specified affiliate, or others
 - Include transfers under § 83 and pursuant to stock options
 - Excludes withheld stock to satisfy a withholding obligation
- Excludes
 - Distributions with respect to covered corporation's own stock (i.e., stock splits)
 - Issuances to a specified affiliate
 - Excepted as qualifying property (no double benefit)
 - Deemed issuances under § 304(a)(1)
 - Deemed Issuance of a fractional share
 - Issuance by a covered corporation that is a dealer in securities
 - Issuance by target in an A reorg by reason of § 368(a)(2)(E)

Netting Rules: Dividend Exception

- Excise Tax = 1% * (Repurchased Stock – Qualifying Property – Issuances – **Dividend Exception**)
- Reduced to the extent repurchase is treated as a dividend under §§ 301(c)(1) or 356(a)(2)
 - Treated as essentially equivalent to a dividend (not described in § 302(b))
- A repurchase to which §§ 302 or 356(a) apply are presumed ineligible for the dividend exception
 - “Sufficient evidence” rebuttal safe harbor

Fair Market Value

- Fair-Market Value of Publicly Traded Stock (choose one/year)
 - Daily volume-weighted average price on date of repurchase
 - Closing price on date of repurchase
 - Average of high and low prices on date of repurchase
 - Trading price at time of repurchase
- Non-Publicly Traded Stock
 - Value on date of repurchase under § 409A