

Inflation Reduction Act: New Excise Tax Discourages Stock Repurchase Transactions

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On August 16, 2022, President Biden signed the Inflation Reduction Act of 2022, HR 5376 (the “Act”), into law. Among other significant changes, the Act includes a new 1% excise tax on stock repurchase transactions by certain publicly traded corporations (the “Excise Tax”). The Excise Tax is substantially identical to the excise tax included in numerous versions of the previously proposed Build Back Better Act and is intended to discourage certain publicly traded corporations from engaging in stock repurchase transactions.

Under the Excise Tax, subject to certain exceptions discussed below, a “covered corporation” is subject to a 1% excise tax on the fair market value of certain stock “repurchased” during the covered corporation’s taxable year, irrespective of whether any such repurchase is part of an open-market stock buyback program. In computing the Excise Tax, the fair market value of stock repurchased is reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including any stock issued or provided to an employee of such corporation (including upon exercise of an employee stock option), or to an employee of a “specified affiliate” (as defined below) of such corporation. The Excise Tax applies at a fixed rate without regard to whether such covered corporation has taxable income or loss during the taxable year.

For these purposes, a “repurchase” includes a redemption of stock within the meaning of Code Section 317(b), as well as any transaction determined by the Secretary to be economically similar to a redemption of stock within the meaning of Code Section 317(b). Code Section 317(b) provides that stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired or held as treasury stock.

Accordingly, redemptions subject to the Excise Tax may include an acquisition by a covered corporation: (i) of its own stock for cash, regardless of whether such purchase is made on the open market or in a private transaction, (ii) to effectuate a “bootstrap acquisition” or a leveraged buyout, and (iii) of fractional shares for cash in an acquisition.

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Subject to further guidance from the IRS and U.S. Treasury Department, because the Excise Tax only applies to a repurchase of “stock”, the repurchase of an unexercised option or warrant not otherwise treated as a stock for U.S. federal income tax purposes is not anticipated to be subject to the Excise Tax. Further guidance from the Secretary will be necessary to determine the precise scope of the Excise Tax.

The Act provides that the Excise Tax will not apply to a stock repurchase transaction:

1. to the extent that the repurchase is part of a reorganization (within the meaning of Code Section 368(a)) and no gain or loss is recognized on such repurchase by the shareholder by reason of such reorganization;
2. in any case in which the stock repurchased, or an amount of stock equal to the value of stock repurchased is, contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan;
3. in any case in which the total value of the stock repurchased during the taxable year does not exceed U.S.\$1,000,000;
4. under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business;
5. to repurchases by registered investment companies or real estate investment trusts; or
6. to the extent that the repurchase is treated as a dividend for tax purposes.

For these purposes, a “covered corporation,” includes any U.S. corporation whose stock is traded on an established securities market (e.g., NASDAQ, NYSE, TSX, LSE, etc.) irrespective of the market capitalization of such corporation. A “covered corporation” also includes any non-U.S. corporation treated as a U.S. corporation for U.S. federal income tax purposes pursuant to the anti-inversion rules under Code Section 7874(b) as well as any non-U.S. corporation that is deemed a “surrogate foreign corporation” pursuant to the inversion rules under Code Section 7874(a)(2)(B) on or after September 20, 2021 (and, only for the applicable ten-year period thereafter as contemplated by Code Section 7874(d)(1)) whose stock is traded on an established securities market (e.g., NASDAQ, NYSE, TSX, LSE, etc.) irrespective of the market capitalization of such corporation. The Excise Tax also applies to a covered corporation if its stock is repurchased by a “specified affiliate”, which includes any corporation or partnership which is more than 50 percent owned, directly or indirectly, by the covered corporation.

In addition, U.S. corporations and partnerships (which, for these purposes, includes a non-U.S. partnership with a direct or indirect U.S. entity as a partner) that are “specified affiliates” of a non-U.S. parent corporation will also be subject to the Excise Tax upon the repurchase of stock of its non-U.S. parent corporation if: (i) the non-U.S. parent corporation has stock traded on an established securities market, and (ii) such U.S. domestic corporation or partnership is a “specified affiliate” of the non-U.S. parent corporation. Further, the reductions to the Excise Tax with respect to stock issuances during the taxable year, as described above, are limited to those made by such specified affiliate to its employees.

The new Excise Tax applies to repurchases effected after December 31, 2022. No grandfathering rule currently applies to stock repurchase transactions already authorized

or approved.