

Inflation Reduction Act: New U.S. Excise Tax on Stock Repurchase Transactions Applicable to Certain Canadian Companies

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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”). As described below, publicly traded Canadian companies that:

1. are treated as U.S. corporations for U.S. federal income tax purposes under the anti-inversion rules in Code Section 7874(b);
2. became treated as “surrogate foreign corporations” for U.S. federal income tax purposes on or after September 20, 2021 under the anti-inversion rules in Code Section 7874(a)(2)(B); or
3. are not subject to the anti-inversion rules but that effect a stock repurchase through one or more of its U.S. subsidiaries or affiliates,

will each likely be subject to the Excise Tax.

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.

For these purposes, a “covered corporation,” includes any U.S. corporation, any Canadian or other 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), and any Canadian or other non-U.S. corporation that became deemed a “surrogate foreign corporation” pursuant to the anti-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)), in any case 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

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indirectly, by the covered corporation.

In addition, U.S. corporations and partnerships (which, for these purposes, includes a Canadian or other non-U.S. partnership with a direct or indirect U.S. entity as a partner) that are “specified affiliates” of Canadian parent corporations, including Canadian parent corporations not otherwise subject to the anti-inversion rules, will also be subject to the Excise Tax upon the repurchase of stock of its Canadian parent corporation if: (i) the Canadian 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 Canadian parent corporation. Further, the reductions to the Excise Tax with respect to stock issuances during the taxable year, as described below, are limited to those made by such specified affiliate to its employees.

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 above) 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. 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.

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.

Subject to the promulgation of additional guidance and Treasury Regulations, Canadian corporations described above that directly or indirectly repurchase stock, utilize cross-border equity financing structures or engage in cross-border acquisitions should seek advice to avoid or limit the potential application of the Excise Tax.