

April 17, 2024

# New Proposed Regulations on Excise Tax on Stock Repurchases

## In General & Summary

On Tuesday, April 9, the Treasury Department and IRS issued two sets of proposed Treasury Regulations providing guidance on the corporate stock repurchase excise tax (collectively, the “Proposed Regulations”), which was imposed by the Inflation Reduction Act of 2022 (H.R. 5376) (the “IRA”)<sup>1</sup> and effective January 1, 2023. The Proposed Regulations provide additional clarity to taxpayers on the applicability of the non-deductible 1% excise tax on repurchases of corporate stock (the “Excise Tax”) and largely adopt the framework of IRS Notice 2023-2 (the “Notice”) but modify the Notice in certain important respects.<sup>2</sup> The Proposed Regulations effectively replace the guidance provided in the Notice, and may generally be relied upon until final regulations are published.<sup>3</sup>

In addition, the Proposed Regulations address procedural aspects of the Excise Tax including with respect to tax return filing mechanics. These procedural aspects are generally not addressed in this Memorandum, although notably they postpone the requirement to report and pay the Excise Tax until following the first full quarter after final regulations are published, consistent with IRS Announcement 2023-18.

## Analysis

*In General.* The IRA imposes a non-deductible 1% excise tax on repurchases after December 31, 2022 (including purchases by certain affiliates and other economically similar transactions) of any stock of any U.S. corporation that has any publicly traded shares (a “Covered Corporation”).<sup>4</sup> “Repurchase” is broadly defined as a Section 317(b) redemption<sup>5</sup> and any economically similar transaction, as well as the acquisition of a Covered Corporation’s stock by certain of its affiliates from a third party.<sup>6</sup> The

<sup>1</sup> On February 14, 2023, U.S. Senators Sherrod Brown and Ron Wyden introduced the Stock Buyback Accountability Act of 2023 which would increase the Excise Tax from 1% to 4%. As of the date of this Memorandum, the proposed legislation has not been enacted into law.

<sup>2</sup> For previous discussion and analysis of the IRA and the Notice, see our Client Memorandums published August 9, 2022, “[Inflation Reduction Act Imposes Corporate Minimum Tax and an Excise Tax on Stock Repurchases](#)” and December 29, 2022, “[IRS Issues Guidance on Excise Tax on Stock Repurchases and Corporate Alternative Minimum Tax](#).”

<sup>3</sup> See Proposed Regulations §58.6011-1(d); the Proposed Regulations do not adopt any special transition relief for certain repurchases that occur pursuant to a binding commitment entered into before the IRA was promulgated but that closed on or after January 1, 2023. See, generally, Proposed Regulations, Explanation of Provisions, Part I.E.

<sup>4</sup> As discussed below, the Excise Tax also applies to certain corporations that have expatriated and are subject to the “inversion rules” of Section 7874. Unless otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended (the “Code”). Special rules govern the applicability of the Excise Tax to repurchases of stock of certain foreign corporations. See Proposed Regulations §58.4501-7.

<sup>5</sup> Certain Section 317(b) redemptions are excluded from the statutory definition of repurchase, including, but not limited to: (i) a deemed redemption resulting from the application of Section 304(a)(1); (ii) a payment of cash to shareholders in lieu of fractional shares in connection with a reorganization under Section 368(a) and (iii) stock issued by a Covered Corporation that is a dealer in securities. See generally Proposed Regulations, Explanation of Provisions, Part XI.C.

<sup>6</sup> Proposed Regulations §58.4501-2(e). Moreover, the Proposed Regulations provide that a “repurchase” includes certain constructive specified affiliate acquisitions where (i) prior to an acquisition, a privately-held target corporation uses its cash on hand to acquire all of the stock of the acquiring Covered Corporation and (ii) after the acquisition, the target is a “specified affiliate.” The constructive specified affiliate rule is intended to prevent Covered Corporations from realizing the economic benefits of repurchasing their own stock without incurring the Excise Tax. See Proposed Regulations §58.4501-2(f)(3)(i).

Proposed Regulations provide an exclusive list of transactions that are considered economically similar transactions for purposes of the Excise Tax including acquisitive reorganizations, E reorganizations, F reorganizations, split-offs and certain liquidations.<sup>7</sup> The Excise Tax is imposed on the fair market value of the stock repurchased, minus the fair market value of any stock issued (including certain stock that is issued to employees of the Covered Corporation or of certain affiliates as compensation for services) by such corporation during the taxable year (the “Netting Rule”).<sup>8</sup> In addition, the Excise Tax base excludes the fair market value of “qualifying property” exchanged for repurchased shares (generally stock delivered in certain reorganizations or split-offs that would otherwise be subject to the tax).<sup>9</sup> Notably, consistent with the Notice, the Proposed Regulations do not permit carryforwards or carrybacks of unused reductions under the Netting Rule.<sup>10</sup>

#### *M&A Issues.*

- *LBOs and “Take Private” Transactions.* The Proposed Regulations confirm that, in a taxable transaction, to the extent that the consideration in an LBO or other taxable acquisition is funded by the target corporation’s own cash or borrowed cash, the target is treated as repurchasing its own stock in a transaction subject to the Excise Tax.<sup>11</sup>
- *Qualifying Property in Acquisitive Reorganizations.* The Proposed Regulations provide that an exchange of target corporation stock by the target corporation’s shareholders in an acquisitive reorganization is treated as an economically similar transaction to a repurchase. In an acquisitive reorganization (*i.e.*, an A reorganization (including triangular A reorganizations), a C reorganization, an acquisitive D reorganization and an acquisitive G reorganization), a recapitalization (*i.e.*, an E reorganization) or a mere change in a Covered Corporation’s identity, form, or place of organization (*i.e.*, an F reorganization),<sup>12</sup> the acquirer’s stock consideration is excluded from the tax base to which the Excise Tax applies. To the extent other non-qualifying consideration (*e.g.*, cash) is used, however, the tax base is not reduced by such non-qualifying consideration. The effect is that the Excise Tax applies to cash consideration received in these transactions.

Though in a taxable transaction the cash consideration funded by the acquiring corporation does not give rise to a repurchase funded by target, in an acquisitive reorganization, the Proposed Regulations create a repurchase by a target corporation even where the cash used as merger consideration in a reverse triangular merger of the acquiring corporation’s subsidiary with and into the target is funded by the acquiring corporation (with the acquiring corporation contributing such cash to the merger subsidiary before the merger).<sup>13</sup> The Proposed Regulations state that the exchange by the target shareholders of their target stock for the merger consideration qualifies as a transaction that is economically similar to a redemption, even where the cash is funded by the acquiring corporation.<sup>14</sup>

<sup>7</sup> See Proposed Regulations §58.4501-2(e)(4).

<sup>8</sup> See Proposed Regulations, Explanation of Provisions, XI.A.

<sup>9</sup> Certain “issuances” are not treated as issuances for purposes of the Netting Rule under the Proposed Regulations where the effect of the issuance would be to artificially reduce a Covered Corporation’s Excise Tax liability permitted by the Netting Rule (*i.e.*, a Covered Corporation’s distribution of stock with respect to its existing stock).

<sup>10</sup> Proposed Regulations, Explanation of Provisions, XIV.E.

<sup>11</sup> See *generally* Proposed Regulations, Explanation of Provisions, Part VII.A. For example, in a transaction where a parent corporation acquires a target using a merger subsidiary that borrows funds and merges with and into the target and the target’s shareholders exchange all of their stock for cash, the target is treated as if it repurchased its stock to the extent that its own cash (including cash attributable to such debt financing) funded the transaction and the repurchase would otherwise be subject to the Excise Tax. Notice 2023-02, §3.09, Ex. 3.

<sup>12</sup> The Proposed Regulations also added a transaction that qualified as a reorganization under Section 368(a)(1)(G) (if the reorganization satisfied the requirements of Section 354(b)(1)).

<sup>13</sup> See Proposed Regulations §58.4501-5(b)(19).

<sup>14</sup> See *id.*

Cash paid in lieu of fractional shares will generally remain outside the scope of the Excise Tax.<sup>15</sup> However, any cash paid to dissenters in connection with an acquisitive reorganization may be subject to the Excise Tax where such cash payments are treated as Section 317(b) redemptions under general federal income tax principles.<sup>16</sup>

- *Spin-Offs, Split-Ups and Split-Offs.* The Proposed Regulations clarify that a spin-off<sup>17</sup> generally does not qualify as a repurchase (and therefore is generally not subject to the Excise Tax) because Distributing does not provide consideration to its shareholders in exchange for its own stock.<sup>18</sup> Note, however, that if, in connection with a spin-off that is part of a reorganization under Section 368(a)(1)(D), Distributing purges boot received in the exchange by repurchasing its shares, that repurchase will be subject to the Excise Tax.<sup>19</sup> With regard to a split-up,<sup>20</sup> the Proposed Regulations clarify that such transactions likewise generally do not constitute repurchases because Distributing completely liquidates.<sup>21</sup> If, however, the split-up includes a distribution of non-qualifying property, such as cash (or, as discussed below, Controlled securities), in exchange for Distributing stock, then the exchange of such non-qualifying property for Distributing stock constitutes a repurchase.<sup>22</sup> While not completely clear under the Proposed Regulations, the calculation of the Excise Tax base would parallel that applied in the context of a split-off, as described below.<sup>23</sup> Similar to the case with acquisitive reorganizations, the effect is that the Excise Tax applies to cash consideration (and Controlled securities) received in these transactions.

With respect to split-offs, such transactions are generally subject to the Excise Tax.<sup>24</sup> However, the fair market value of the repurchased Distributing stock that is exchanged for qualifying property (*i.e.*, Controlled stock (regardless of whether part of a D reorganization)) reduces the tax base for the Excise Tax.<sup>25</sup> Accordingly, if no non-qualifying property is exchanged for Distributing stock, the split-off should not attract the Excise Tax. The preamble to the Proposed Regulations also clarifies that a distribution by Distributing of Controlled securities in exchange for Distributing stock in connection with a split-off is a repurchase to which the Excise Tax applies – refusing to extend qualified property treatment to securities of Controlled.<sup>26</sup>

- *Complete Liquidations; SPACs.* The Proposed Regulations provide that a redemption occurring pursuant to a complete liquidation of a Covered Corporation is not a “repurchase.”<sup>27</sup> This would generally include SPAC liquidations.<sup>28</sup> Under the Notice there was a concern that a liquidation of a SPAC would not be eligible for the exemption because founders’ shares might not receive a distribution in certain cases. The Proposed Regulations clarify that where the SPAC sponsor has waived rights to liquidating distributions (which is common practice in the SPAC market) such that a subsequent liquidation of the SPAC does not include liquidating distributions to the Sponsor in connection with founder shares, the SPAC’s liquidating distributions to other stockholders are not *per se* barred from qualifying for the statutory exception and would be subject to

<sup>15</sup> Proposed Regulations §58.4501-2(e)(3)(ii).

<sup>16</sup> Proposed Regulations, Explanation of Provisions, XIV.C.

<sup>17</sup> Meaning, a transaction in which a distributing corporation (“Distributing”) makes a non-redemptive pro-rata distribution of stock of a controlled corporation (“Controlled”) to Distributing’s shareholders that qualifies for tax-free treatment under Section 355, whether or not part of a reorganization under Section 368(a)(1)(D).

<sup>18</sup> Proposed Regulations §58.4501-2(e)(5)(iii)(A); Proposed Regulations, Explanation of Provisions, Part. IX.A.

<sup>19</sup> See Section 361(b)(1)(A) and Proposed Regulations §58.4501-5(b)(14).

<sup>20</sup> Meaning, a transaction in which Distributing makes a liquidating distribution of stock of more than one Controlled.

<sup>21</sup> Proposed Regulations §58.4501-2(e)(5)(i); Proposed Regulations, Explanation of Provisions, Part. IX.A.

<sup>22</sup> Proposed Regulations §58.4501-2(e)(5)(iii)(B); Proposed Regulations, Explanation of Provisions, Part. IX.A.

<sup>23</sup> Meaning, a transaction in which Distributing makes a redemptive distribution of Controlled stock and, if applicable, cash or other property.

<sup>24</sup> Proposed Regulations §58.4501-2(e)(4)(iv).

<sup>25</sup> Proposed Regulations §58.4501-3(c)(4). If the split-off includes a distribution of other consideration that is not qualifying property like cash, however, the tax base is not reduced by such non-qualifying consideration.

<sup>26</sup> Proposed Regulations, Explanation of Provisions, Part. IX.B.

<sup>27</sup> Proposed Regulations §58.4501-2(e)(5)(A). Specifically, if the liquidation is one to which either Section 331 or 332 (but not both) applies, then the liquidation is not a repurchase. *Id.* However, if Section 331 and 332(a) apply respectively to component distributions of a complete liquidation of a Covered Corporation, the distributions to which Section 331 (but not Section 332(a)) apply are repurchases to which the Excise Tax applies.

<sup>28</sup> The Treasury Department and IRS are of the view that no special rules are needed to address SPAC transactions.

the general rule that a distribution pursuant to a plan of complete liquidation or dissolution of a Covered Corporation is generally not a repurchase for purposes of the Excise Tax.<sup>29</sup>

In addition, the Proposed Regulations clarify that issuances of stock by a post-combination entity do not count as issuances by the SPAC for purposes of the Netting Rule.<sup>30</sup> This is relevant in a de-SPAC transaction where the SPAC is not the acquiror and therefore does not itself issue any stock in the transaction.

#### *Certain Capital Markets Issues.*

- ***Preferred Stock Redemptions Are Subject to Excise Tax.*** The Proposed Regulations confirm that a Covered Corporation's redemption of preferred stock, which includes the redemption of "participating" preferred stock, convertible preferred stock and mandatorily redeemable preferred stock (all of which may be non-publicly traded for these purposes), is subject to the Excise Tax where the redeemed property is stock for federal income tax purposes and the repurchase is a redemption within the meaning of Section 317(b).<sup>31</sup> Accordingly, where a Covered Corporation has outstanding, publicly traded common stock and non-publicly traded, mandatorily redeemable preferred interests that are stock for federal income tax purposes, redeeming the preferred stock generally triggers the Excise Tax.<sup>32</sup> The Proposed Regulations, however, explicitly carve out preferred stock that qualifies as additional tier 1 capital for regulated financial institutions ("Additional Tier 1 Preferred Stock").<sup>33</sup>
- ***Convertible Debt, Options and Other Financial Instruments.*** The preamble to the Proposed Regulations clarifies that convertible debt instruments that are properly characterized as debt under federal income tax principles at the time of issuance do not fall within the scope of the Excise Tax and that such instruments do not need to be retested while the instrument is outstanding.<sup>34</sup> Accordingly, even deep-in-the-money convertible debt properly characterized as debt at issuance will not fall within the scope of the Excise Tax if subsequently redeemed or settled for cash. The Proposed Regulations also provide clarity as to whether and when certain financial instruments, including options (physically settled,<sup>35</sup> cash settled<sup>36</sup> or deep-in-the-money<sup>37</sup>), "Section 305(a) warrants,"<sup>38</sup> and synthetic debt instruments resulting from an integrated transaction under Treasury Regulations §1.1275-6,<sup>39</sup> fall within the scope of the Excise Tax.<sup>40</sup>
- ***Stock of Non-U.S. Corporations.*** The Proposed Regulations contain an especially complicated and lengthy regime to address the purchase of stock of non-U.S. corporations directly by U.S. affiliates or purchases that are funded by U.S. affiliates. The indirect funding rule applies to a broad range of intercompany cash movement transactions (e.g., loans, distributions, capital contributions) where a U.S. entity funds the purchase of stock of a non-U.S. corporation and a principal purpose of the funding is to avoid the Excise Tax that would have otherwise been imposed had the U.S. entity purchased the stock directly. In certain cases, the determination of whether a principal purpose is avoidance of the Excise Tax is a factual determination. However, with fundings of downstream (i.e., lower tier) affiliates, the Proposed Regulations provide for a rebuttable presumption in the case of any funding that is within two years of a covered purchase. Note, the approach

<sup>29</sup> Proposed Regulations §58.4501-2(e)(5)(i); Proposed Regulations, Explanation of Provisions, Part XIV.G.2.

<sup>30</sup> Proposed Regulations, Explanation of Provisions, Part XIV.G.3.

<sup>31</sup> Proposed Regulations §§58.4501-1(b)(29), 58.4501-2(e)(2); Proposed Regulations, Explanation of Provisions, Part II.A.1.

<sup>32</sup> Proposed Regulations §§58.4501-1(b)(29), 58.4501-2(e)(2); Proposed Regulations, Explanation of Provisions, Part II.A.1. The market price of such non-publicly traded stock is determined by a reasonable valuation method (as defined in the Treasury Regulations) as of the date the stock is repurchased by the Covered Corporation. Proposed Regulations §58.4501-2(h)(3).

<sup>33</sup> Proposed Regulations §58.4501-1(b)(29)(ii). By corollary, the issuance of Additional Tier 1 Preferred Stock would not be taken into account for purposes of the Netting Rule. Proposed Regulations, Explanation of Provisions, Part II.A.3.

<sup>34</sup> Proposed Regulations §58.4501-1(b)(29); Proposed Regulations, Explanation of Provisions, Part II.A.4 and Part II.B.

<sup>35</sup> Proposed Regulations §§58.4501-5(b)(26) and (28).

<sup>36</sup> Proposed Regulations §§58.4501-2(e)(5)(v), 58.4501-4(f)(12) and 58.4501-5(b)(27) and (29).

<sup>37</sup> Proposed Regulations §58.4501-2(e)(5)(v).

<sup>38</sup> Proposed Regulations §§58.4501-2(e)(5)(v), 58.4501-4(f)(12); Proposed Regulations, Explanation of Provisions, Part II.C.3 and 5.

<sup>39</sup> Proposed Regulations, Explanation of Provisions, Part II.C.6.

<sup>40</sup> See, generally, Proposed Regulations, Explanation of Provisions, Part II.C.

adopted by the Proposed Regulations is more taxpayer-friendly than the *per se*, non-rebuttable two-year rule put forth in the Notice. In cases where a U.S. affiliate purchases or funds a repurchase of stock by a foreign parent/affiliate, the U.S. affiliate is generally liable for the Excise Tax. This regime, including the funding rule, is expected to have far-reaching implications for non-U.S. corporations with U.S. affiliates.

*Operation of the Excise Tax.*

- *Determining the Fair Market Value of Repurchased Shares.* The Proposed Regulations adopt the guidance in the Notice with respect to the determination of Fair Market Value of repurchased shares. The Proposed Regulations follow the Notice in providing that the fair market value of repurchased or issued stock is the market price of such stock on the date the stock is repurchased or issued, and specify acceptable methods for determining market price.<sup>41</sup> Thus, regardless of whether the price at which the stock is repurchased differs from the market price, the fair market value of the stock for purposes of computing the Excise Tax is the market price on the date the stock is repurchased.<sup>42</sup>
- *Distributions and Dividends.* To implement the statutory exception for repurchases treated as dividends under the Code, the Proposed Regulations provide that the portion of the repurchase that is treated as a dividend reduces the Covered Corporation’s Excise Tax base in an amount equal to the fair market value of the stock repurchased (subject to the substantiation requirements discussed below). Moreover, the Proposed Regulations clarify that the entirety of a non-redemptive distribution is exempt from the Excise Tax (*i.e.*, the dividend portion, the portion that reduces basis and the portion taxed as gain).<sup>43</sup>

The Proposed Regulations include further guidance on the substantiation requirements to rebut the presumption that repurchases generally do not qualify for dividend treatment.<sup>44</sup> Covered Corporations can rebut this presumption for a given repurchase from a given shareholder by establishing with “sufficient evidence” that such shareholder treats the repurchase as a dividend on such shareholder’s federal income tax return. The Proposed Regulations expand on what constitutes “sufficient evidence” and replace the Notice’s requirement that the Covered Corporation provide information reporting to the redeemed shareholder with a requirement that the Covered Corporation obtain shareholder certification as to dividend treatment.<sup>45</sup> These substantiation requirements are onerous and may be difficult to apply to repurchases from small shareholders as a practical matter.

\* \* \*

---

<sup>41</sup> See Proposed Regulations §58.4501-2(h)(1); Notice 2023-02, §3.06(2).

<sup>42</sup> The Proposed Regulations provide for four different methods of valuing the market price of stock traded on an established securities market: (i) daily volume-weighted average price; (ii) daily closing price; (iii) daily average high-low price or (iv) trading price when stock is repurchased or issued. Importantly, the Proposed Regulations stipulate that taxpayers must consistently apply the same method of determining the market price to all repurchases (or issuances) throughout the same taxable year. See Proposed Regulations §58.4501-2(h)(2)(ii)(A)-(D).

<sup>43</sup> Proposed Regulations §58.4501-2(e)(5)(iv); Proposed Regulations, Explanation of Provisions, Part V.A.

<sup>44</sup> Proposed Regulations §58.4501-3(g)(2); Proposed Regulations, Explanation of Provisions, Part X.F.

<sup>45</sup> Proposed Regulations §58.4501-3(g)(2)(iii)(B); Proposed Regulations, Explanation of Provisions, Part X.F.1.b.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Reuven Garrett  
+1-212-373-3767  
[rgarrett@paulweiss.com](mailto:rgarrett@paulweiss.com)

Brian S. Grieve  
+1-212-373-3768  
[bgrieve@paulweiss.com](mailto:bgrieve@paulweiss.com)

Robert Holo  
+1-212-373-3637  
[rholo@paulweiss.com](mailto:rholo@paulweiss.com)

Sohail Itani  
+1-212-373-3582  
[sitani@paulweiss.com](mailto:sitani@paulweiss.com)

Matthew B. Jordan  
+1-212-373-3921  
[mjordan@paulweiss.com](mailto:mjordan@paulweiss.com)

Robert A. Killip  
+1-212-373-3907  
[rkillip@paulweiss.com](mailto:rkillip@paulweiss.com)

Brian Krause  
+1-212-373-3332  
[bkrause@paulweiss.com](mailto:bkrause@paulweiss.com)

Timothy Lowe  
+011-44-20-7367-1618  
[tlowe@paulweiss.com](mailto:tlowe@paulweiss.com)

Anne McGinnis  
+1-212-373-3268  
[amcginnis@paulweiss.com](mailto:amcginnis@paulweiss.com)

Cian O'Connor  
+011-44-20-7367-1619  
[coconnor@paulweiss.com](mailto:coconnor@paulweiss.com)

Brad R. Okun  
+1-212-373-3727  
[bokun@paulweiss.com](mailto:bokun@paulweiss.com)

Lindsay B. Parks  
+1-212-373-3792  
[lparks@paulweiss.com](mailto:lparks@paulweiss.com)

Jeffrey B. Samuels  
+1-212-373-3112  
[jsamuels@paulweiss.com](mailto:jsamuels@paulweiss.com)

Scott M. Sontag  
+1-212-373-3015  
[ssontag@paulweiss.com](mailto:ssontag@paulweiss.com)

*Associates Jeremy D. Kelly and Danielle J. Rabinowitz contributed to this Client Memorandum.*