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Treasury and IRS Issue Guidance on Excise Tax on Share Repurchases by Publicly Traded Corporations

05 January 2023

On December 27, 2022, the U.S. Department of Treasury and the Internal Revenue Service released Notice 2023-2 (the "Notice"), which provides preliminary guidance on the application of the recently enacted 1% excise tax on certain stock redemptions and economically similar transactions (corporate "repurchases") by publicly traded U.S. corporations ("Covered Corporations"), effective January 1, 2023 (the "Excise Tax"). The Excise Tax is imposed on, and must be paid by, the applicable Covered Corporation. Taxpayers are permitted to rely on the Notice until the issuance of forthcoming proposed regulations.[1] The U.S. Department of Treasury and the IRS have requested comments on the guidance in the Notice as well as certain areas not covered in the Notice.

The guidance contained in the Notice is broad in scope. It applies the Excise Tax to a wide range of transactions, many of which are not commonly thought of as "share buybacks." Some key areas of guidance include:

Leveraged Buyouts and Taxable Cash Acquisitions

- The Excise Tax applies to buyout transactions of a target Covered Corporation to the extent cash or other consideration is sourced from the target (e.g., the cash is traced to target balance sheet cash or to the proceeds of new target debt, including debt incurred by a merger subsidiary and assumed by the target in a taxable reverse subsidiary merger).
- The Excise Tax generally does not apply with respect to consideration attributable to debt financing incurred by the purchaser.

Application to SPACs

- Share redemptions made by domestic SPACs, including in connection with a business combination or an extension request, are generally subject to the Excise Tax, although the value of shares subject to the Excise Tax can be reduced (i.e., netted) by the value of any shares issued pursuant to an investment into the SPAC (e.g., in a PIPE transaction) in the same taxable year (along with certain other stock issuances in the same taxable year — see discussion below).
- Share redemptions in complete liquidation of a Covered Corporation, as defined under the tax rules, are generally exempt from the Excise Tax. In addition, the Notice extends this relief to any distributions that occur in the *same taxable year* as a complete liquidation, even if the distribution occurs prior to adopting the plan of liquidation.
- Non-U.S. SPACs are generally not subject to the Excise Tax. However, if a non-U.S. SPAC undergoes a U.S. domestication in connection with a de-SPAC that gives rise to redemption rights, the SPAC could be subject to the Excise Tax if the redemptions occur after the U.S. domestication.

Public Trading and Preferred Stock

- If a Covered Corporation has any publicly traded class of stock outstanding, repurchases of a non-traded class of stock (including non-traded preferred stock) are subject to the Excise Tax. Note that the definition of "publicly traded" is quite broad and can include over-the-counter markets and similar exchanges.
- The Excise Tax applies to mandatorily redeemable preferred stock, even if the stock was issued prior to January 1, 2023. The Notice requests comments on whether special rules should be issued with respect to preferred stock.
- The Excise Tax generally does not apply to convertible debt, although the IRS requested comments on the issue. The IRS also requested comments on whether special rules should apply to bankrupt or troubled companies.

Certain Reorganizations, Split-Offs and Other Divisive Transactions

- Certain Section 368 reorganizations and Section 355 split-offs are exempt from the Excise Tax to the extent the transaction consideration consists of stock eligible for nonrecognition treatment. Such transactions are potentially subject to the Excise Tax to the extent of any "boot" (i.e., cash, other property and non-qualified preferred stock).
- A divisive transaction under Section 355 other than a split-off (e.g., a spin-off) is exempt from the Excise Tax.
- Cash in lieu of fractional shares received pursuant to a Section 368 reorganization, or a Section 355 spin- or split-off, is generally exempt if the payments are made for administrative convenience and not as separately bargained-for consideration.

Repurchases Treated as Dividends

- A repurchase by a Covered Corporation that is treated as a dividend for tax purposes is exempt from the Excise Tax.
- For purposes of the Excise Tax, a repurchase is generally presumed *not* to be treated as a dividend unless the Covered Corporation provides evidence to rebut this presumption. This contrasts with presumed dividend treatment in other contexts (e.g., whether a repurchase constitutes a dividend for U.S. withholding tax purposes). The evidentiary burden is high and, in some cases, will be difficult to satisfy, even for a transaction that the Covered Corporation (or applicable withholding agent) in fact treats as a dividend.

Timing and Fair Market Value of Repurchased Stock

- Stock is treated as repurchased at the time ownership (for tax purposes) transfers to the repurchasing corporation. The fair market value of the repurchased stock is determined as of that date using one of four valuation methods (or, if non-publicly traded, using a reasonable valuation method under the Section 409A regulations).
- Stock that was repurchased prior to 2023 pursuant to an accelerated share repurchase ("ASR") agreement is generally not subject to the Excise Tax. However, the Excise Tax could apply to any additional shares required to be delivered in 2023 in final settlement of the ASR.

Reduction in Excise Tax Base for Certain Stock Issuances

- The Notice clarifies that the Excise Tax base is reduced by the aggregate fair market value of stock issued by the Covered Corporation, or provided by the Covered Corporation to employees, during the taxable year (with the fair market value being determined at the time the stock is issued or provided).
  - The Notice also clarifies that corporate contributions of stock to employer-sponsored retirement plans reduce the Excise Tax base.

- Certain stock issuances are not netted, such as stock issued to existing shareholders in respect of their stock (i.e., stock dividends), stock withheld to satisfy the exercise price of a stock option or to satisfy employer withholding tax obligations, stock issued to certain related parties, and stock issued in certain Section 368 reorganizations involving targets that are Covered Corporations.
  - However, stock issued in Section 368 reorganizations involving targets that are *not* Covered Corporations can be netted for purposes of reducing the Excise Tax base of the acquirer.

For further questions regarding the Notice and the application of the Excise Tax, please reach out to any member of the Kirkland tax team, including the authors below.

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1. There is no indication of when proposed regulations may be issued. ↩

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Suggested Reading

- 23 January 2023 - 25 January 2023 Speaking Engagement USC Gould School of Law 2023 Tax Institute
- 05 January 2023 Press Release Kirkland Represents Cressey & Company on Acquisition of The InterMed Group
- 05 January 2023 Press Release Kirkland Counsels Third Coast Infrastructure on Amendment and Restatement of Its Existing $465 Million Portfolio Financing