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Kirkland Alert

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

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On April 12, 2024, the U.S. Department of Treasury and the Internal Revenue Service published proposed regulations regarding the 1% excise tax on certain stock redemptions and economically similar transactions (corporate “repurchases”) by publicly traded U.S. corporations (“Covered Corporations”) on or after January 1, 2023, described in Section 4501 of the Internal Revenue Code (the “Excise Tax”). The proposed regulations effectively replace Treasury’s and the IRS’s prior guidance in Notice 2023-2 (the “Notice”) and may generally be relied upon by taxpayers until the regulations are finalized. Treasury and the IRS have requested comments on the proposed regulations.

The proposed regulations reflect Treasury’s and the IRS’s consideration of comments and criticisms received with respect to the Excise Tax and prior guidance, including in response to the Notice. The proposed regulations narrow the scope of the widely criticized “per se” funding rule for repurchases and acquisitions of a publicly traded foreign corporation’s stock funded by a U.S. subsidiary, but otherwise largely follow the framework set forth in the Notice. For a summary of certain key areas of guidance set forth in the Notice, see our January 5, 2023, *Alert*: [“Treasury and IRS Issue Guidance on Excise Tax on Share Repurchases by Publicly Traded Corporations.”](#)

Some noteworthy aspects of the proposed regulations include:

- **Leveraged Buyouts and Taxable Cash Acquisitions:** Under both the Notice and the proposed regulations, the Excise Tax applies to acquisitions of a target Covered Corporation to the extent the consideration is sourced to the target (or sourced from

third-party debt incurred by a transitory merger sub that merges into the target in a reverse subsidiary merger). The preamble to the proposed regulations clarifies that the sourcing of debt for purposes of the Excise Tax is based on general U.S. federal income tax principles. As such, it appears the Excise Tax does not apply to cash consideration in a leveraged buyout to the extent the consideration is sourced from debt financing incurred at the acquiror level, rather than at the target level.

- **SPACs:** Despite requests from commenters, the proposed regulations do not provide any relief specific to SPACs. The proposed regulations do, however, provide helpful clarification on certain transactions commonly undertaken by SPACs. First, the proposed regulations clarify that where a foreign corporation (including a SPAC) redeems certain shareholders immediately prior to domesticating in an F-reorganization, the Excise Tax generally will not apply to such redemptions. Second, the proposed regulations clarify that SPAC liquidations generally will qualify for the exception to the Excise Tax for corporate dissolutions even if a share class (e.g., the founder shares) does not receive a cash distribution.
- **Narrowing of the “Funding Rule”:** The proposed regulations narrow the scope of the so-called “funding rule” contained in the Notice, although it remains broad. The funding rule generally subjects certain publicly traded foreign corporations’ stock repurchases or acquisitions to the Excise Tax if a direct or indirect U.S. subsidiary of such foreign corporation (i) directly or indirectly funds that repurchase or acquisition “by any means” (e.g., through distributions, debt or capital contributions) and (ii) the “principal purpose” of the funding was to avoid the Excise Tax. The Notice contained a bright-line rule under which such a principal purpose was deemed to exist whenever the funding occurred within two years of the repurchase. This *per se* rule drew significant criticism from tax advisers and, under the proposed regulations, has been replaced with a rebuttable presumption that applies only in a more limited set of circumstances.
- **Cessation Rules:** The proposed regulations clarify that a corporation generally is treated as a Covered Corporation beginning on the date its stock starts to be publicly traded and ending on the date its stock ceases to be publicly traded (its “cessation date”). Thus, when a Covered Corporation is taken private or otherwise ceases to be a Covered Corporation, generally only stock issuances and repurchases on or prior to the cessation date are taken into account for Excise Tax purposes. If, however, a corporation ceases to be a Covered Corporation pursuant to a plan that includes repurchases after the cessation date, those planned repurchases may be subject to the Excise Tax.
- **Convertible Debt and Similar Financial Instruments:** The preamble to the proposed regulations confirms that the Excise Tax will only apply to repurchases of

instruments that are treated as stock for U.S. Federal income tax purposes at the time of their issuance. Thus, convertible debt, an option contract or any similar financial instrument is not “stock” for purposes of the Excise Tax unless the instrument is recharacterized as stock when issued (e.g., a deep in-the-money option that is deemed exercised at issuance for U.S. federal income tax purposes).

- **Preferred Stock and Mandatorily Redeemable Stock:** With the limited exception of “additional tier-one preferred stock” of certain regulated financial institutions, the proposed regulations do not provide any exceptions to the potential application of the Excise Tax for preferred stock, convertible preferred stock or mandatorily redeemable stock, including where such stock was issued prior to enactment of the Excise Tax.

For questions regarding the proposed regulations 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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