

# Inflation Reduction Act: Excise Tax on Stock Buybacks

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**PRACTICES** Corporate, Tax

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On August 16, 2022, President Joe Biden signed the Inflation Reduction Act of 2022 (the “Act”) into law. The Act introduced a new excise tax on public company stock buybacks.

## **Imposition of Tax**

The Act imposes a non-deductible 1% excise tax on the fair market value of the stock of a covered corporation that is repurchased in a given year, less the fair market value of any stock issued in that year. A “covered corporation” is any domestic corporation whose stock is traded on an established securities market, such as the NASDAQ and certain qualifying foreign exchanges. The excise tax will apply to repurchases of stock that occur after December 31, 2022, and currently does not provide for any relief to taxpayers who pre-authorized stock repurchases or issued mandatory redeemable preferred stock prior to the passage of the Act.

The excise tax applies to all of the stock of a covered corporation, including classes of stock which are not publicly traded regardless of whether the corporation has earnings and profits or losses.

The Act provides the Treasury Department with regulatory authority to apply the excise tax to other transactions that it determines are “economically similar” to stock redemptions.

## **Exceptions**

The Act contains several exceptions to the excise tax, including any repurchase of stock:

- in which the total value of the repurchased stock in a given year does not exceed \$1,000,000;
- that is part of a reorganization under §368 and no gain or loss is recognized by the shareholder by reason of the reorganization;
- that is contributed to an employer-sponsored retirement plan or other similar stock compensation plan;
- by a dealer of securities in the ordinary course of business;
- by a regulated investment company or a real estate investment trust; or
- that is taxed as a dividend.

## **Applications to Non-U.S. Corporations**

While the excise tax is primarily levied on domestic corporations, it will also apply when a U.S. specified affiliate of a publicly traded non-U.S. corporation repurchases stock of its foreign parent corporation. The tax is imposed upon the specified affiliate as if it were a U.S. corporation repurchasing its own stock. A “specified affiliate” is an entity that is more than 50% owned, directly or indirectly, by a corporation.

## **De-SPAC Transactions**

Prior to a de-SPAC transaction, initial SPAC investors may elect to have their shares be redeemed. Barring any future regulatory guidance, the SPAC entity will be subject to the excise tax upon those redemptions, even though the SPAC investors are generally just recouping their original capital investment and in theory are not receiving any income. The amount of stock repurchased that is subject to the excise tax is adjusted down by the amount of SPAC shares issued in the initial public offering, but only if those shares are issued in the same year that the de-SPAC transaction occurs. The amount of stock repurchased that is subject to the excise tax could also be reduced by PIPE issuances, warrant exercise issuances, or issuances of stock to SPAC employees.

Absent further guidance from the Treasury, it is possible that distributions of property in partial or complete liquidation of a covered corporation may be viewed as a “repurchase” subject to the excise tax. If the SPAC ultimately fails to merge with a company to take public, then the excise tax may be triggered on the winding up of the SPAC.

## **§355 “Split-Offs”**

At this time, it is also unclear whether the stock of the controlled corporation in a §355 split-off transaction distributed in exchange for stock of the distributing corporation would be subject to the excise tax. The exchange of stock in a corporation for stock of the corporate subsidiary is generally treated as a redemption for income tax purposes.

§355(c) allows distributee shareholders in a tax-deferred split-off that is not a part of a reorganization to still receive tax-deferred treatment on the transaction. In that case, the distribution of stock could fall out of the reorganization exception and be subject to the excise tax. Further, as noted above even if the §355 split-off is part of a reorganization, the corporation could still be subject to the excise tax if there is gain to the distributee on the distribution.

We expect many of these issues to be addressed and refined by future IRS guidance. Please reach out to our tax lawyers below to review how the excise tax may be applied to a given transaction.