

The Stock Repurchase Excise Tax: Questions of Timing and Valuation

By Jeff Maydew and Mike Tenenboym*

In this article, Maydew and Tenenboym explore when stock is “repurchased” or “issued” and how it is valued for purposes of the new buyback tax.

The stock repurchase excise tax is a study in contradiction.¹ It targets stock buybacks but catches many other transactions in its net.² It purports to deter stock buybacks but their pace has increased since its enactment.³ It stirs passionate calls for its repeal and equally passionate calls to quadruple its rate.⁴

One thing is clear: this new tax is fully in effect for publicly traded companies and, thanks to early guidance from the Treasury Department and the Internal Revenue Service in Notice 2023-2 (the “Notice”), its contours are coming into focus.⁵

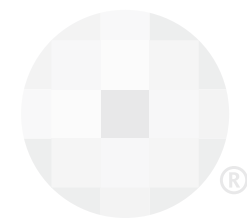
In this article, we focus on two aspects of the Repurchase Tax architecture—when is stock “repurchased” or “issued” and how is stock valued at the time of those events. For ease of reference, we refer throughout to the tax as the “Repurchase Tax.”

In a Nutshell

The Repurchase Tax imposes a tax on each “covered corporation”—*e.g.*, a U.S. publicly traded corporation⁶—equal to one percent of the value of the stock of the covered corporation treated as repurchased during a year.⁷ More specifically, the tax liability equals one percent of a covered corporation’s “stock repurchase excise tax base” for the year (the “Tax Base”).⁸ A taxpayer generally determines its Tax Base through a three-step process.⁹

In step one, the covered corporation aggregates the value of all of its relevant repurchases for the tax year.¹⁰ A “repurchase” for this purpose is very much a term of art, and includes a broad array of transactions that go beyond a “stock buyback” in the colloquial sense.¹¹

In step two, the covered corporation reduces the first step amount by the value of stock repurchases attributable to transactions during the tax year to which a “statutory exception” applies (*e.g.*, when a covered corporation subsequently contributes repurchased stock to an employer-sponsored retirement plan).¹²



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Last, in step three, the covered corporation reduces the amount remaining after step two—but not below zero—by the aggregate value of stock that it issues or provides during the tax year (the “Netting Rule”).¹³

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As an excise tax, the Repurchase Tax applies at a flat rate without regard to whether the covered corporation has taxable income or loss during the year.¹⁴ Further, the Repurchase Tax applies irrespective of the market capitalization or revenue of the covered corporation. The Repurchase Tax does not have any carryforward or carry-back mechanism to allow for multi-period adjustments.¹⁵

A taxpayer will report the Repurchase Tax, like other excise taxes, on Internal Revenue Service (“IRS”) Form 720, the *Quarterly Federal Excise Tax Return*.¹⁶ Although a taxpayer files Form 720 on a quarterly basis, it computes the Repurchase Tax on an annual basis and reports it once a year.¹⁷ A calendar-year taxpayer generally will first report its Repurchase Tax on a Form 720 that it files for the first quarter of 2024—*i.e.*, on April 30, 2024. A taxpayer will compute the Repurchase Tax on Form 7208, the *Excise Tax on Repurchase of Corporate Stock*, a new form that currently exists in draft form only.¹⁸

The Repurchase Tax filing deadline is also the payment deadline.¹⁹ A taxpayer cannot receive an extension to report or pay the tax owed.²⁰ Once paid, Repurchase Tax expense is non-deductible for U.S. federal income tax purposes.²¹ For U.S. financial statement purposes, covered corporations will typically treat the tax as a cost of acquiring repurchased shares, a result that generally impacts the balance sheet but not corporate earnings.²²

When Is Stock Repurchased or Issued and What Is Its Value?

The statute is conspicuously silent with respect to two issues of great import to the Tax Base: (i) the date that a covered corporation treats a repurchase or issuance of

stock as occurring, and (ii) the value that applies to such stock.

When Is Stock Repurchased?

Since the inception of the U.S. income tax, taxpayers have had to determine the date when stock ownership is treated as “transferred” for many reasons. With respect to the Repurchase Tax, the Notice clarifies that, in general, “[s]tock is treated as repurchased at the time at which, for Federal income tax purposes, *ownership of the stock transfers* to the covered corporation or to the applicable acquirer (as appropriate).”²³ For this purpose, although not explicitly stated, a “benefits and burdens of ownership”-type analysis should apply. This type of analysis, which is described in detail in *Grodt & McKay Realty, Inc.*,²⁴ has previously been applied in the context of Code Sec. 317(b) stock redemptions. As an example, in *H.J. Heinz Co.*,²⁵ the Court of Federal Claims stated that “[t]he mere record of stock ownership is but the starting point in this analysis—one consideration among many in determining whether one is the owner of property.” The court then found that the incidence of stock ownership depended upon all the facts and circumstances, in particular: (i) whether the purchaser bears the risk of loss and opportunity for gain; (ii) which party receives the right to any current income from the property; (iii) whether legal title has passed; and (iv) whether an equity interest was acquired in the property.

The clarification of when ownership of stock transfers occurs should be especially welcome for covered corporations engaging in accelerated share repurchases (“ASRs”). In general, a company structures an ASR as follows: (i) the company pays a bank an upfront cash amount based on the product of the number of shares it desires multiplied by an estimated price per share; (ii) a bank borrows the allotted number of shares from the public markets, and delivers the shares to the company; (iii) the bank then purchases shares in the market in an amount equal to the number of shares it borrowed, returning the shares it borrowed to its stock lenders; and (iv) at settlement, the parties adjust the upfront cash payment amount to account for the “true” price of the shares (*e.g.*, measured using a metric such as a 20-day volume-weighted average price) during the time the agreement is outstanding, subject to other adjustments.

Prior to the Notice, companies were left to wonder whether a repurchase pursuant to an ASR should be deemed to occur (i) at the time the bank delivers the shares to the company—*e.g.*, at the time the company makes the upfront, estimated cash payment or,

alternatively; (ii) at the time the bank actually purchases shares in the market and the parties can determine the definitive price of the shares under the ASR agreement. The Notice resolves much of that ambiguity through a helpful example.²⁶ In the example, a corporation, X, enters into an ASR agreement with a bank on October 10, 2022. Pursuant to the ASR agreement, (i) X pays the bank a prepayment amount, (ii) the bank borrows 80 shares of X stock on the open market, and (iii) the bank delivers the purchased X shares to X on October 12, 2022. Separately, the ASR agreement provides that, upon final settlement, the bank may be required to deliver additional X shares to X, which the bank in fact does when it delivers an additional 20 X shares to X on February 1, 2023. For purposes of determining the relevant repurchase dates to determine X's Tax Base, the example concludes that the ASR agreement—in combination with other facts and circumstances—demonstrates that, for U.S. federal income tax purposes, X became the owner of (i) the 80 initially transferred shares on their date of delivery (October 12, 2022), and (ii) the 20 subsequently transferred shares on their date of delivery (February 1, 2023). Thus, the example demonstrates that, for purposes of the Repurchase Tax, a covered corporation that engages in an ASR should treat the date that it actually receives shares as its relevant stock ownership date.

When Is Stock Issued or Provided?

Under the Netting Rule, a covered corporation determines its Tax Base for a tax year by reducing repurchase amounts by the aggregate value of stock that such corporation issues or provides (i) to its employees (or those of a specified affiliate) during its tax year, or that it (ii) issues or provides to any other person.²⁷

As in the case of Repurchases, the Notice provides that “[s]tock is treated as issued or provided by a covered corporation at the time at which, for Federal income tax purposes, ownership of the stock transfers to the recipient.”²⁸ The Notice then clarifies that, in general, a covered corporation treats stock as issued or provided to *an employee* on the date that the employee becomes the beneficial owner of the stock for Federal income tax purposes (the “Beneficial Transfer Rule”).²⁹ In general, a covered corporation treats an employee as the beneficial owner of the stock when it transfers the stock to the employee and the stock substantially vests within the meaning of Reg. §1.83-1(b).³⁰ As an example, a covered corporation should treat a transfer of stock pursuant to a stock award that vests as “issued or provided” when the covered corporation initiates payment of the stock.³¹ The Notice

provides further detail for specific situations—*e.g.*, in the case of stock appreciation rights or when stock is the subject of a valid Code Sec. 83(b) election.³²

As described above, the Beneficial Transfer Rule applies when a covered corporation issues or provides stock to an employee. Under the Notice, a covered corporation issues or provides stock to an employee in any arrangement under which it issues or provides stock to an employee as compensation for services performed (*e.g.*, a transfer of stock to which Code Sec. 83 applies).³³ Although the Beneficial Transfer Rule does not explicitly apply to nonqualifying arrangements, or when a covered corporation issues or provides stock to a non-employee (*e.g.*, in a merger or acquisition, to a supplier, to a consultant, *etc.*), it stands to reason that a “benefits and burdens of ownership”-type analysis should still apply in those other contexts.

What Value Applies to Repurchased and Issued Stock?

Once a covered corporation identifies the date of repurchase or issuance, the next question becomes what value it should apply to that repurchased or issued stock. For this purpose, the Notice provides that a covered corporation that trades its stock on an established securities market can use one of four acceptable methods to determine the value of stock it repurchases or issues:

- (i) The daily volume-weighted average price as determined on the date the stock is repurchased/issued;
- (ii) The closing price on the date the stock is repurchased/issued;
- (iii) The average of the high and low prices on the date the stock is repurchased/issued; or
- (iv) The trading price at the time the stock is repurchased/issued.³⁴

The value conventions eliminate many valuation questions that otherwise might arise in terms of discounts or premiums for large blocks of stock or otherwise. However, all of the Notice's suggested conventions measure the value of repurchased or issued stock by reference to its trading price on the market, instead of the amount the covered corporation actually pays in the transaction. Therefore, value determinations disregard any purchasing costs incurred by the company when repurchasing the relevant shares. Of course, the converse is true in the case of stock issuances—a covered corporation does not take into account its transaction costs when determining the value of stock issued.

From a planning standpoint, because a covered corporation will not need to file its first Form 720 until

after year end, it should perform alternative calculations before filing its return to determine which of the above conventions generates the least amount of Repurchase Tax liability. Once a covered corporation adopts a convention, it must use that convention to determine the value of all stock it repurchases or issues on an established securities market for the relevant tax year, as made clear by the following “consistency requirement”:

The market price of repurchased stock that is traded on an established securities market must be determined by consistently applying one (but not more than one) of the methods provided ... to all repurchases throughout the covered corporation’s taxable year. That same method also must be consistently applied to determine the market price of all stock issued under the netting rule throughout the covered corporation’s taxable year, other than stock issued to employees.³⁵

Interestingly, the “consistency rule”—notwithstanding its name—suggests that a covered corporation can change the convention it uses from year to year. Thus, all taxpayers subject to the Repurchase Tax seemingly will be able to model the alternative conventions on an annual basis without being constrained by one method for more than one year.³⁶ Further, changing the convention used should not require an accounting method change request because it relates to an issue of valuation (of fact), and not of timing.³⁷

Conclusion

These are still early days for the Repurchase Tax, and more guidance will be forthcoming in the form of proposed and, ultimately, final regulations. Until then, taxpayers may rely on the general guidance provided in the Notice to determine the date of a repurchase or issuance of stock, and its value—two fundamental questions that Congress left to Treasury to address.

ENDNOTES

* The authors thank John Robert for his helpful contributions to this article.

¹ Code Sec. 4501.

² NEW YORK STATE BAR ASSOCIATION TAX SECTION, *Report on the Section 4501 Excise Tax on Repurchases of Corporate Stock*, at Part V (Nov. 1, 2022).

³ As of February 8, 2023, companies announced more than \$170 billion of planned buybacks in the first weeks of 2023, an amount that doubles last year’s pace. *See, e.g.*, Chandra Wallace, *Mega-Buybacks Sparks Debate Over Raising Excise Tax Rate*, 178 TAX NOTES FEDERAL 1030 (Feb. 13, 2023); Lewis Krauskopf, *Factbox: U.S. Stock Buybacks so Far in 2023: Big Money, Fewer Companies*, REUTERS (Feb. 7, 2023).

⁴ *See, e.g.*, H.R. 8853 (Sep. 15, 2022) (legislation introduced to repeal the Repurchase Tax); S. 413 (Feb. 14, 2023) (legislation introduced to increase the Repurchase Tax rate from one percent to four percent).

⁵ Until the issuance of proposed regulations, taxpayers generally may rely on the rules described in the Notice. *See* Notice, section 5.03.

⁶ In specified circumstances, the Repurchase Tax may also apply to repurchases made by a U.S. corporation, U.S. partnership, or foreign partnership having a direct or indirect U.S. partner affiliate with a foreign publicly traded corporation. Foreign-parented groups also can be caught by the tax, particularly as a result of an expansive *per se* “funding” rule. *See* Notice, section 3.05(2)(a)(ii)(B); *see also, e.g.*, Andrew Velarde, *Excise Tax Per Se Funding*

Rule Has Cash-Pooling Taxpayers Worried, 109 TAX NOTES INT’L 673 (Jan. 30, 2023).

⁷ Code Sec. 4501(a). For purposes of the Repurchase Tax, qualifying repurchases include those made by the covered corporation itself, as well as its “specified affiliates.” Notice, section 2.02(2).

⁸ Notice, section 3.03(1).

⁹ Notice, section 3.03(3)(a).

¹⁰ Notice, section 3.03(3)(a)(i).

¹¹ The statute generally defines a “repurchase” as a redemption within the meaning of Code Sec. 317(b) and “economically similar” transactions, subject to certain exceptions. Code Sec. 4501(c). The Notice provides additional guidance on the types of transactions that fall within the ambit of the Repurchase Tax. *See* Notice, sections 3.04(3) and (4).

¹² Notice, section 3.03(3)(a)(ii). Code Sec. 4501(e) and Notice, section 3.07 describe the “statutory exceptions” to repurchase treatment.

¹³ Notice, section 3.03(3)(a)(iii).

¹⁴ A *de minimis* rule prevents the tax from applying if the aggregate value of repurchased stock does not exceed \$1 million. Notice, section 3.03(2). The IRS and Treasury have requested comments on whether an exclusion or other special rules should apply to bankrupt or troubled companies. Notice, section 6.02(3).

¹⁵ *See* Notice, section 3.03(3)(c).

¹⁶ Notice, section 4.

¹⁷ *Id.*

¹⁸ The draft form is available at www.irs.gov/pub/irs-dft/f7208--dft.pdf.

¹⁹ Notice, section 4.

²⁰ *Id.*

²¹ Code Sec. 275(a)(6).

²² We understand the Repurchase Tax is not within the scope of ASC 740, Income Taxes, because it is not considered a tax on income under Generally Accepted Accounting Principles. Thus, the tax generally is accounted for as part of the cost of repurchasing the bought-back stock. *See, e.g.*, RSM, *Executive Summary: Year-end ASC 740 Considerations* (Jan. 4, 2023).

²³ Notice, section 3.06(1)(a) (emphasis added).

²⁴ In *Grodt & McKay Realty Inc.*, 77 TC 1221, Dec. 38,472 (1981), the court addressed whether cattle were truly sold in a transaction in which there was no transfer of title, right to possession, control, or dominion over the “sold” cattle. The court considered whether the relevant transactions “were *bona fide* arm’s-length sales for federal income tax purposes, or whether they lacked the commercial, legal, and economic substance of sales.” For purposes of its analysis, the court articulated eight factors that it considered relevant to whether a property transfer occurred for tax purposes—*i.e.*, whether the “benefits and burdens of ownership [had] passed.”

²⁵ *H.J. Heinz Co and Subsidiaries*, FedCl, 2007-1 USTC ¶150,517, 76 FedCl 570 (2007).

²⁶ Notice, section 3.09(15).

²⁷ Notice, section 3.08(1).

²⁸ Notice, section 3.08(2).

²⁹ Notice, section 3.08(3)(a)(i).

³⁰ Notice, section 3.08(3)(b)(i).

³¹ Notice, section 3.08(3)(b)(i).

³² Notice, section 3.08(3)(b)(ii) & (iii).

³³ In certain cases, a covered corporation will not treat stock as “issued or provided”; for example, if it withholds the stock to satisfy certain withholding obligations or the exercise price of a stock option. Notice, section 3.08(3)(a)(ii) & (iii).

³⁴ Notice, section 3.06(2)(a)(i) & 3.08(5)(a)(i). Treasury and the IRS solicit comments with respect to whether an amount “other than the

market price” of stock should apply to determine the amount of a covered corporation’s repurchases or issuances. See Notice, section 6.01(2) & (3). Special rules may also be needed for specific scenarios. See, e.g., Notice, section 6.01(5) (soliciting comments with respect to whether special guidance should be provided to determine the market price of stock that is traded on multiple established securities markets).

³⁵ Notice 3.05(2)(a)(iii). See also 3.08(5)(iii) (providing a mirror rule for stock issuances).

³⁶ The ability to choose a new convention each year should prove especially beneficial for covered corporations that experience significant volatility in their stock prices.

³⁷ See, e.g., Reg. §1.446-1(e)(2)(ii)(b) (providing that a change in a method of accounting “does not include a change in treatment resulting from a change in underlying facts.”).

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