Blogs
August 18, 2022
Public Chatter

New Legislation Imposes Excise Taxes on Stock Repurchases: 9 Things to Know

A few days ago, President Biden signed the **Inflation Reduction Act of 2022** into law - and there's a number of items to unpack in it. This blog tackles nine things to know about the new excise tax equal to 1% of the fair market value of any stock repurchased by certain (generally domestic) corporations whose shares are traded on an established securities market:

1. The political rationales for the excise tax are varied, and include decreasing the tax-favored reputation of stock buybacks as compared to dividends (buybacks generally permit offsets for basis in the stock repurchased and capital losses from other investments, whereas dividends do not), and incentivizing businesses to invest in employees rather than appeasing investors who often clamor for buybacks or increasing earnings per share.
2. Unlike taxes on capital gains or dividends, which are imposed on the selling shareholder, this excise tax is imposed on the corporation making repurchases.
3. The amount subject to tax would be reduced by the fair market value of issuances of stock to the public or employees during the taxable year. This provision and others discussed below raise the question - how will fair market value be measured?
4. The tax would not apply if the total value of stock repurchased within a taxable year is less than $1 million.
5. The tax would not apply if the repurchased stock (or an amount equal to the fair market value repurchased) were contributed to an employee pension plan, employee stock ownership plan, or similar plan.
6. The tax would not apply to a repurchase treated as a dividend for federal income tax purposes. Dividend treatment can apply, for example, when a selling shareholder's interest in the corporation is not reduced in connection with the repurchase.
7. The tax would apply to purchases of company stock by a subsidiary (i.e., a corporation or partnership that is directly or indirectly more than 50% owned by the parent).
8. The tax generally would not apply to a repurchase occurring as part of a tax-free reorganization. But, apart from this allowance, the broad definition of "repurchase" may affect more than what we typically think of as corporate buybacks. A number of transaction types could be impacted, such as:

- Redemptions of SPAC shares, including in connection with a de-SPAC transaction.
- Mergers or other reorganizations involving cash payments to the target's shareholders to the extent that such payments are funded with the target's cash or debt incurred or assumed by the target in the transaction.
- Payments of cash in lieu of fractional shares or payments to dissenters in connection with mergers or other reorganizations.
- Redemptions of outstanding preferred stock.
- Leveraged buy-outs.
- "Split-off" transactions.

The Treasury Secretary is authorized to define "repurchase" to include "economically similar" transactions - so even more transactions could be impacted than expected.

9. The tax would only apply to repurchases made after December 31, 2022. While the tax doesn't apply to repurchases until after December 31st, some companies may already have shares outstanding that are subject to repurchase or redemption rights that could be impacted.

These nine items don't tackle all there will be to know about the Inflation Reduction Act, but it's a good starting point…

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