Proposed Excise Tax on Stock Repurchases Has Far-Reaching Implications for Corporate Transactions

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In legislative text released October 28, 2021, the House Rules Committee proposed to impose a 1% excise tax on stock repurchases by publicly traded companies starting in 2022. If the provision is enacted, corporations will need to consider the excise tax in weighing stock repurchase programs. Moreover, the definition of "repurchase" in the proposal is broad enough that the tax might be triggered by certain acquisitions, split-offs and other transactions even though they would not conventionally be viewed as stock repurchases.

The Legislative Text

The excise tax was proposed as part of legislation implementing President Biden's revised framework for reconciliation legislation, the Build Back Better Act (BBBA). The revised BBBA includes a number of significant tax provisions as revenue offsets for the cost of the BBBA's various spending measures. The proposed excise tax on stock repurchases is generally similar to legislation previously introduced by Senator Sherrod Brown (D-Ohio) and Senate Finance Committee Chairman Ron Wyden (D-Ore.) in September 2021.[1]

The provision imposes a 1% excise tax on publicly traded U.S. corporations (and certain U.S. subsidiaries of publicly traded non-U.S. corporations) for the value of any stock that is repurchased during the taxable year by the corporation or "specified affiliates" in which the corporation owns a 50% or greater equity interest. A "repurchase" includes a "redemption" as defined under the U.S. tax code (generally, any acquisition of stock by the corporation in exchange for cash or property other than the corporation's own stock or stock rights) and any other "economically similar" transaction, as determined by the Treasury Secretary.

For purposes of the tax, the amount of repurchases in a given year is reduced by the value of any new issuances of stock during the year. In addition, a repurchase is not subject to the excise tax to the extent (1) the repurchase is part of a tax-free reorganization, and no gain or loss is recognized by the shareholder "by reason of" the reorganization; (2) the repurchased stock or its value is contributed to an employee pension plan, employee stock ownership plan, or similar plan; (3) the total amount of repurchases within the year is less than $1 million; (4) the repurchase is by a dealer in securities in the ordinary course of business; (5) the repurchase is taxed as a dividend to the shareholder (as opposed to "sale or exchange" treatment); or (6) the repurchase is by a regulated investment company or a real estate investment trust. The excise tax would apply to repurchases occurring after December 31, 2021, irrespective of when the repurchase program was authorized.

Potential Consequences and Open Questions

If the provision is enacted as drafted, publicly traded corporations will need to consider the excise tax in weighing the overall costs and benefits of their stock repurchase programs and in evaluating other corporate transactions that may involve "repurchases." As a general matter, the excise tax would make it more costly to engage in stock buybacks of all forms, including (1) routine open market purchases, (2) privately negotiated purchases such as accelerated share repurchase transactions, and (3) purchases in registered self-tender offers.

[1] In a September 10, 2021, press release, Senator Brown described the policy concerns animating the proposal as follows: "Large corporations buy back stock using the capital that could be used to make investments, create new jobs, and raise wages. This practice has further exploded under former President Trump's tax law that overwhelmingly benefited major corporations and the top 1 percent. Stock buybacks also provide a tax arbitrage opportunity for wealthy shareholders, as a means to delay and potentially fully-avoid tax on their share of corporate gains."

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SPACs. The provision also has important ramifications for U.S. special purpose acquisition companies (SPACs). The excise tax would apply to redemptions of stock in connection with a SPAC's initial business combination or "de-SPAC" transaction (subject to potential netting for issuances to PIPE investors and target shareholders), even when a redeeming shareholder is merely recouping its original investment and does not realize any economic gain.

Dividend exception. While it is theoretically possible for a repurchase of publicly traded stock to be taxed as a dividend to the seller, the dividend exception described above would likely be unavailable for the large majority of small public shareholders who are not involved in the corporation's management. In any event, it is usually very difficult for the corporation to ascertain the shareholder-specific facts necessary to establish dividend treatment even when those facts are present.

Redeemable preferred. Although the provision provides an explicit grant of regulatory authority to address preferred stock and other special classes of stock, it does not contain a statutory "grandfathering" rule or other relief for redeemable preferred stock. Absent post-enactment administrative relief, the excise tax would apply to any non-dividend-equivalent redemption of preferred stock occurring after the effective date, even if the stock is mandatorily redeemable and was issued before that date.

Acquisitions. Because of how the provision defines a "repurchase," the excise tax could be triggered in many mergers and acquisitions that do not appear to involve stock repurchases as that term is commonly understood. For example, in a merger involving cash consideration, payments of cash to the target's shareholders would likely be viewed as repurchases to the extent those payments are funded out of the target's existing cash resources or with the proceeds of debt that is incurred or assumed by the target in the transaction.

Similarly, payments of cash in lieu of fractional shares in a stock-for-stock merger would likely be considered repurchases to the extent the cash is sourced from the acquiror instead of from sales of fractional shares into the market. Payments of cash to target shareholders who exercise dissenters' rights would also likely fall within the provision's scope.

Split-offs. While it is unclear if this is the intent, the definition of "repurchase" would even seem to include a tax-free split-off transaction in which a parent corporation exchanges stock of a controlled subsidiary for a portion of the parent's outstanding stock. A split-off is technically a "redemption" for tax purposes, and although split-offs are usually effected as part of a "divisive" tax-free reorganization, the exchanging shareholders' tax-free treatment generally applies regardless of whether a reorganization occurs (*i.e.*, it is not clear that such treatment is "by reason of" the reorganization). Subjecting split-offs to the excise tax would increase the friction costs associated with these transactions and could make it relatively more attractive to structure a tax-free corporate separation as a non-redemptive, pro rata spin-off.

Other transactions that might be taxed. The broad "economically similar" language in the provision's definition of "repurchase" could potentially sweep in an even wider range of corporate transactions. Absent clarifying statements in the legislative history or regulatory guidance, this catchall language could be interpreted to reach (1) payments of cash or other "boot" to target shareholders in partially tax-free reorganizations, (2) similar payments in mergers of equals and other "double dummy" combination transactions, and (3) cash consideration in certain taxable stock acquisitions in which there is 50% or greater overlap in the shareholder bases of the acquiror and the target.

"Economically similar" might also be interpreted as covering distributions by a corporation undergoing a complete liquidation process, or as part of a "partial liquidation," for example, where the corporation disposes of a business line and distributes the proceeds to its shareholders.

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