

# Treasury Releases Proposed Regulations on 1% Tax on Stock Buybacks

April 18, 2024

The Treasury Department recently released Proposed Regulations providing guidance on the rules governing the non-deductible 1% excise tax on corporate stock buybacks by publicly traded companies (the “Buyback Tax”). The Buyback Tax applies to repurchases of public company stock made after December 31, 2022.

Treasury provided initial administrative guidance on the Buyback Tax in Notice 2023-2 (the “Notice”). The Notice provided helpful direction in several areas but also subjected a wider range of transactions to the tax than many had hoped. The Proposed Regulations generally track the approach of the Notice but modify the approach to buybacks of stock of public foreign corporations. In its explanation of the Proposed Regulations, Treasury rejected comments requesting relief in a number of areas, including for buybacks of preferred stock and for taxable “boot” provided by acquirers in connection with acquisitive tax-free reorganizations.

When applicable, the Buyback Tax imposes an additional tax on regular stock buyback programs, as well as taxable M&A transactions where consideration is treated as funded by the target company and tax-free reorganizations that provide shareholders with cash or boot. Current Biden Administration proposals would increase the Buyback Tax rate from 1% to 4%, which, if adopted, would significantly increase the importance of these considerations.

---

## Buyback of Stock of Public Foreign Corporations

- The Buyback Tax has international reach and may apply when U.S. companies purchase stock of a public non-U.S. affiliate. The Proposed Regulations include an anti-abuse rule that applies the Buyback Tax when a U.S. affiliate provides direct or indirect funding to a non-U.S. affiliate (including the non-U.S. public corporation itself) for covered purchases of shares of the public corporation’s stock, and a principal purpose of that covered funding is to avoid the Buyback Tax. The Proposed Regulations include a broad statement that, if a principal purpose of the covered

funding is to fund a covered purchase, then there is a principal purpose of avoiding the Buyback Tax.

- The Proposed Regulations replace the Notice’s controversial “per se” funding rule with a narrower rebuttable presumption rule that is limited to situations involving funding of lower-tier entities that are 25% owned by applicable U.S. affiliates. However, the Proposed Regulations rejected requests for relief for ordinary course intercompany transactions.
- The Notice’s unfavorable per se funding rule still applies for buybacks made prior to April 13, 2024, unless the taxpayer elects to adopt the Proposed Regulations wholesale.

**Comment:** In view of the broad funding rule, non-U.S. groups should review carefully intercompany dealings with U.S. affiliates, including cash pooling arrangements.

---

## Preferred Stock Repurchases and PIPES

- The Proposed Regulations generally apply the Buyback Tax to any instrument treated as stock for tax purposes. However, additional Tier 1 capital of banks is exempt from the Buyback Tax in light of the need for regulatory approval for its redemption or repurchase.
- Treasury rejected requests for relief for redemptions of non-publicly traded stock. As a result, the Buyback Tax applies not only to a repurchase of publicly traded common stock, but also to a redemption of a public corporation’s non-traded stock, such as private investments in public equity securities (“PIPES”) and non-traded preferred stock.

**Comment:** Issuers of PIPES should consider the impact of the Buyback Tax on potential redemptions and consider whether an instrument that is treated as debt for tax purposes is available. Public companies may also consider providing flexibility to exchange non-publicly traded stock for publicly traded stock that holders can sell into the market.

---

## Timing of Repurchases

- Under the Proposed Regulations, the Buyback Tax applies to a public company for the full day on which it goes public until the end of the date on which all of its stock ceases to be traded. However, additional payments made pursuant to a plan to acquire shares subject to the Buyback Tax remain subject to the Buyback Tax even after a company has gone private.

**Comment:** Buyers should consider the Buyback Tax implications of using deferred consideration in public company acquisitions.

---

## Taxable Acquisitions; Leveraged Buyouts

- The Proposed Regulations confirm that, in a taxable acquisition of a public company, the Buyback Tax applies to the extent the consideration is sourced from the public company under general tax principles. For example, this rule applies to leveraged buy-outs where some of the cash is funded by new debt incurred by the public company or incurred by a transitory merger subsidiary that is merged into the public company in connection with the acquisition.

**Comment:** Buyers should consider financing the acquisition of a public target at the level of the acquirer, rather than pushing debt into the formerly public target, and will need to evaluate the effect of post-closing debt push-downs.

---

## Other Covered Transactions

- The Proposed Regulations extend the Buyback Tax to a list of specified transactions that are economically similar to buybacks, such as certain stock-for-stock transactions. For these transactions, the Buyback Tax generally applies only to the extent of taxable consideration.
- Tax-free reorganizations are generally subject to the Buyback Tax, but the Buyback Tax would generally only be payable with respect to any cash or other taxable consideration payable to shareholders of the public acquired company. These rules are less favorable than the rules for taxable transactions because they subject the public acquired company to the Buyback Tax with respect to all of the cash consideration received by public shareholders, rather than just any portion sourced from the target public company as is the case for taxable acquisitions.

- In a split-off, where a controlled corporation is distributed only to certain shareholders, boot is subject to the Buyback Tax. In a spin-off, where a controlled corporation is distributed to all shareholders, pro rata distributions of boot are not subject to the Buyback Tax, but any distributions of boot in exchange for shares of the distributing corporation are subject to the Buyback Tax.
- While the Proposed Regulations describe the list of economically similar transactions as exclusive (and therefore limited), Treasury reserves the right to update in the future, including on a non-prospective basis where appropriate.
- The Proposed Regulations provide relief with respect to certain deemed stock repurchases and certain payments of cash for fractional shares.

**Comment:** While consistent with the Notice, the Proposed Regulations' approach to tax-free reorganizations is likely to attract continued comments.

---

## Presumption against Dividend Treatment

- The Buyback Tax includes an exception for buybacks that are taxed as dividends. The Proposed Regulations generally retain the Notice's approach of requiring shareholder certifications to access this exception and add additional certification requirements, such as certain ownership details and signing under penalty of perjury. The Proposed Regulations rejected requests to allow public companies to rely on their information or withholding tax reporting to claim the dividend exception.
- The certification requirements do not apply to corporate distributions, which are excluded from the Buyback Tax regardless of whether they are treated as dividends for tax purposes.

**Comment:** In the context of a public company that is widely held, providing sufficient evidence to rebut a presumption on a shareholder-by-shareholder basis may introduce administrative complexity and cost, which the additional requirements will exacerbate.

---

## Corporate Liquidations and SPACs

- Under the Proposed Regulations, the Buyback Tax generally does not apply to complete corporate liquidations, except as to minority owners of a public company that has an 80% or greater corporate shareholder.

- The rule for complete liquidations generally provides relief to special purpose acquisition companies (“SPACs”) that do not acquire an operating business within a specified time frame and are subsequently required to be liquidated. However, repurchases in connection with a de-SPAC transaction, in which the repurchasing company does not liquidate, would still be subject to the Buyback Tax.

---

## Netting of Stock Issuances and Repurchases

- The Proposed Regulations provide detailed rules that permit a public company to net certain stock issuances against buybacks, where both the issuances and the buybacks are in the same taxable year. The rules exclude issuances that occur before the applicable company goes public or after it goes private.
- The Proposed Regulations deny netting benefits to issuances by acquiring corporations in reorganizations and controlled corporations in spin-offs and split-offs.
- The Proposed Regulations deny any upfront netting benefit for instruments that are not in the legal form of stock, even if treated as equity for tax purposes. This contrasts with the repurchase rule, which imposes the Buyback Tax on purchases of any instrument treated as equity for tax whether or not in the form of stock.

**Comment:** Public companies should consider whether stock redemptions can be timed to occur in the same tax year as stock issuances to minimize the application of the Buyback Tax.

---

## Procedural Reporting Requirements and Applicability Dates

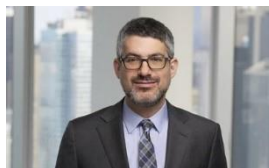
- The Proposed Regulations generally apply to applicable stock repurchases after December 31, 2022. However, taxpayers can generally rely on Notice provisions for transactions occurring prior to the publication of the Proposed Regulations, subject to certain consistency requirements.
- Buyback Tax returns and payments generally will be due no earlier than one full calendar quarter after the publication of final regulations.

\* \* \*

Please do not hesitate to contact us with any questions.



**Cécile Beurrier**  
Partner, London  
+44 20 7786 9146  
cbeurrier@debevoise.com



**Michael Bolotin**  
Partner, New York  
+1 212 909 6013  
mbolotin@debevoise.com



**Rafael Kariyev**  
Partner, New York  
+1 212 909 6383  
rkariyev@debevoise.com



**Peter F.G. Schuur**  
Partner, New York  
+1 212 909 6353  
pfgschuur@debevoise.com



**Olivia Coral Daniels**  
Associate, New York  
+1 212 909 6058  
odaniels@debevoise.com



**Jose Faina**  
Associate, Hong Kong  
+852 2160 9828  
jfairaro@debevoise.com



**Weichi Liu**  
Associate, New York  
+44 20 7786 9173  
wliu@debevoise.com



**Robert Nelson-Sullivan**  
Associate, New York  
+1 212 909 6148  
rnelsonsullivan@debevoise.com



**Charlie Daley**  
Law Clerk, New York  
+1 212 909 6196  
bcdaley@debevoise.com



**Lauren Lin**  
Law Clerk, New York  
+1 212 909 6660  
llin1@debevoise.com



**Corey Mavleos**  
Law Clerk, New York  
+1 212 909 6163  
cmavleos@debevoise.com



**Isabel Shipman**  
Law Clerk, New York  
+1 212 909 7462  
lshipman@debevoise.com

*This publication is for general information purposes only. It is not intended to provide, nor is it to be used as, a substitute for legal advice. In some jurisdictions it may be considered attorney advertising.*