

Treasury Releases Final Regulations Limiting Scope of 1% Stock Buyback Excise Tax

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The Treasury Department recently released Final Regulations providing guidance on the rules governing the nondeductible 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.

In a taxpayer-favorable turn, the Final Regulations pare back many provisions of the 2024 Proposed Regulations that attracted comments. Most notably, the Final Regulations remove the “funding rule,” which applied to non-U.S. public corporations, and cease applying the Buyback Tax to take-private transactions and most tax-free reorganizations. The Final Regulations position the Buyback Tax more directly towards regular-way stock repurchases by publicly traded companies and exempt a number of non-ordinary course transactions and issuances.

PUBLIC FOREIGN CORPORATIONS—END OF THE FUNDING RULE

- The Final Regulations limit the international reach of the Buyback Tax by removing a controversial “funding rule” which appeared nowhere in the statute and which applied the Buyback Tax to the repurchase of public foreign stock by a foreign issuer if the proceeds of the repurchase were sourced from its U.S. affiliates.

Comment: The removal of the “funding rule” is a welcome relief, as it might have applied to buybacks that were determined to be funded with distributions from U.S. subsidiaries and ordinary course cash management and treasury functions. However, the Buyback Tax still applies to purchases of public foreign corporation stock by the corporation’s U.S. affiliates.

PREFERRED STOCK REPURCHASES AND PIPES

- While the Final Regulations continue to apply the Buyback Tax to repurchases of preferred stock, they exempt the redemption of nonvoting, debt-like preferred stock from the application of the Buyback Tax.
- The Final Regulations also exempt the redemption of stock issued prior to the passage of the Buyback Tax on August 16, 2022, if such stock is subject to a mandatory redemption by the issuer or a unilateral put by the holder.

Comment: Public issuers of PIPEs or SPACs with redeemable shares that were issued prior to August 16, 2022, will now be able to redeem such shares without paying the Buyback Tax.

TAKE-PRIVATE ACQUISITIONS; TAX-DEFERRED TRANSACTIONS

- The Final Regulations exempt take-private and leveraged buyouts from the Buyback Tax if the transaction results in the public company ceasing to be publicly traded.

Comment: The application of the Buyback Tax to leveraged buyouts may have increased the tax cost of borrowings by target corporations in take-private transactions if acquisition debt was incurred by the target corporation. This exemption will help acquirors optimize a formerly public target's state tax profile and avoid special structuring.

- For tax-free acquisitive reorganizations, the Final Regulations allow taxpayers to receive cash boot without triggering the Buyback Tax. Upstream reorganizations or liquidations of subsidiaries with minority public stock are similarly no longer subject to the Buyback Tax.

Comment: Cash boot received in split-off transactions is still subject to the Buyback Tax. Cash boot received in a spin-off transaction may avoid the Buyback Tax if the boot is treated as a dividend.

PRESUMPTION AGAINST DIVIDEND TREATMENT

- The Buyback Tax does not cover buybacks that are treated as dividends for U.S. tax purposes. While the Final Regulations retain a presumption against treating repurchases as dividends, they relax the rules regarding rebuttal of the presumption.

- Under the Final Regulations, a public corporation may use its own information to rebut the presumption that buybacks are not taxed as dividends. This is an improvement from the Proposed Regulations, which required a certification from the shareholder that the shareholder would treat the repurchase as a dividend for U.S. tax purposes.

TAX REFUNDS

- A corporation that has previously paid the Buyback Tax but would not be required to do so under the Final Regulations may receive a refund by filing an amended quarterly return after the effective date of the Final Regulations.



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