



# TaxNewsFlash

United States



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## KPMG report: Analysis and observations on initial guidance on new 1% stock repurchase excise tax

The U.S. Treasury Department and IRS on December 27, 2022, released an advance version of [Notice 2023-2](#) [PDF 312 KB] (52 pages), providing taxpayers with interim guidance on the new 1% excise tax on repurchases of corporate stock under section 4501, created by Pub. L. No. 117-169 (commonly called the “Inflation Reduction Act of 2022” (IRA)), which takes effect January 1, 2023. Read [TaxNewsFlash](#)

The IRS also released, on December 28, 2022, an early release [draft of Form 7208](#) [PDF 240 KB], *Excise Tax on Repurchase of Corporate Stock*, for affected taxpayers to attach once a year to their Form 720, *Quarterly Federal Excise Tax Return*.

### Overview

Notice 2023-2 provides that, until the issuance of forthcoming proposed regulations, taxpayers may rely on the operating rules described in section 3 of the notice for purposes of the stock repurchase excise tax. Specifically, section 3 of the notice sets forth certain rules for computation of the excise tax liability, including: (1) certain general ordering and operating rules; (2) certain rules for determining the fair market value of stock repurchased and issued during the tax year; (3) an exclusive list of certain section 317(b) redemptions that are not treated as repurchases subject to the excise tax, an exclusive list of transactions that are treated as economically similar to repurchases subject to the excise tax, and a non-exclusive list of transactions that are treated as not economically similar to repurchases and therefore not subject to the excise tax; (4) certain rules pertaining to the application of the exceptions to the excise tax set forth under section 4501(e) (i.e., certain transactions specifically not treated as repurchases subject to the excise tax under that statutory provision, the “statutory exceptions”); and (5) an exclusive list of issuances that are disregarded for purposes of the adjustment described in section 4501(c)(3), (d)(1)(C), or (d)(2)(C) (i.e., the reduction to the amount of stock repurchased subject to the excise tax for certain issuances of stock during the same tax year, the “netting rule”).

Section 3 of the notice:

- Sets forth certain general ordering and operating rules for computation of the excise tax liability. The excise tax liability is generally computed as 1% of the total fair market value of the stock repurchased during the tax year, reduced, first, by the fair market value of any such stock to which one of the statutory exceptions of section 4501(e) applies (other than the de minimis exception, as discussed below), and second, by the fair

market value of stock issued or provided during the tax year to which the netting rule applies. No carryforwards or carrybacks are available for purposes of the statutory exceptions or the netting rule in the event that the amount of the foregoing reductions exceeds the amount of stock repurchased during the tax year subject to the excise tax. The determination of whether an instrument that is issued or repurchased is stock for purposes of the excise tax is made based on the determination of the classification of the instrument for U.S. federal income tax purposes as of the date of issuance. Except in the case of certain issuances of stock to employees or employer-sponsored retirement plans, stock is generally treated as issued or repurchased on the date on which ownership of the stock is transferred for U.S. federal income tax purposes. In the case of issuances of stock to employees pursuant to the exercise of options or stock acquisition rights, the stock is treated as issued on the date of exercise. In the case of issuances of restricted stock to which section 83 applies to employees (i.e., stock that is either non-transferable or subject to substantial risk of forfeiture), the stock is not treated as issued or provided to the employee until it vests, unless the employee makes an election under section 83(b) with respect to the stock (in which case it is treated as issued as of the date on which it is transferred to the employee). In addition, there is a special timing rule (as discussed below), pursuant to which transfers of stock to employer-sponsored retirement plans or similar plans (and not treated as repurchases under a statutory exception), during the first quarter following the close of a tax year, may be treated as transferred to such plan during the preceding tax year.

- Provides rules for determining the fair market value of stock issued and repurchased during the tax year for purposes of the computations described in the preceding paragraph. The fair market value of stock on the date of issuance or repurchase is the “market price.” In the case of stock traded (or stock the same class of which is traded) on an established securities market, the market price is determined on the trading day of the issuance or repurchase (or, if the issuance or repurchase does not occur on a trading day, the immediately preceding trading day) under any one of the following methods consistently applied throughout the tax year (i.e., with respect to both issuances and repurchases, except in the case of certain issuances of stock to employees or employee-sponsored retirement plans, as discussed below): (1) the daily volume-weighted average price; (2) the closing price; (3) the average of the high and low prices; or (4) the trading price at the time of the issuance or repurchase. In the case of stock not traded on an established securities market, the trading price is determined under the principles of Treas. Reg. § 1.409A-1(b)(5)(iv)(B)(1). In either case, if the market price is determined in a currency other than U.S. dollar (USD), the market price is converted into USD at the spot rate (as defined in Treas. Reg. § 1.988-1(d)(1)) on the applicable date.
- Sets forth an exclusive list of certain section 317(b) redemptions that are not treated as repurchases subject to the excise tax and an exclusive list of transactions treated as economically similar to repurchases subject to the excise tax. On the one hand, the notice clarifies that all redemptions within the meaning of section 317(b) for U.S. federal income tax purposes are repurchases subject to the excise tax, except for an exclusive list of certain section 317(b) redemptions that are not treated as such. Specifically, the section 317(b) redemptions that are not treated as repurchases solely include the following transactions: (1) all deemed distributions in redemption of stock that result from transactions to which section 304(a)(1) applies; (2) payments of cash in lieu of fractional shares in section 368(a) reorganizations and section 355 distributions, provided that such payments are not separately bargained for consideration, are made solely for administrative convenience, and do not exceed the value of a single share with respect to any shareholder; and (3) distributions in complete liquidation of a corporation, except for component distributions to which section 331 applies in the case of complete liquidations to which both section 331 and section 332 apply. As mentioned above, the foregoing list of section 317(b) redemptions not treated as repurchases is exclusive. Therefore, all other redemptions under section 317(b) are treated as repurchases subject to the excise tax, except to the extent one of the statutory exceptions applies (as discussed below). Such transactions include, for example, leveraged buyouts to the extent consideration is furnished by the target corporation (e.g., due to incurrence or assumption of debt by the target corporation).

On the other hand, the notice provides an exclusive list of other transactions that are treated as repurchases or economically similar to repurchases subject to the excise tax. That list solely includes the following transactions: (1) the exchange by target shareholders of target stock as part of a reorganization under section 368(a)(1)(A) (including by reason of section 368(a)(2)(D) or (a)(2)(E)), (C), or (D) (that satisfies the requirements of section 354(b)(1)) (each, an “acquisitive reorganization”); (2) an exchange by recapitalizing shareholders of their

recapitalizing corporation stock in a recapitalization under section 368(a)(1)(E) (an “E reorganization”); (3) an exchange of transferor corporation stock as part of a reorganization under section 368(a)(1)(F) (an “F reorganization”); (4) an exchange of distributing corporation stock in a distribution to which section 355 applies (a “split-off”); (5) component distributions to which section 331 applies in the case of complete liquidations to which both section 331 and section 332 apply (i.e., distributions to minority shareholders in the case of a complete liquidation of a corporation that also has an 80% corporate shareholder distributions which satisfies the requirements of section 332); (6) acquisitions of stock of (i) a covered corporation by a specified affiliate thereof and (ii) an applicable foreign corporation (i.e., a foreign corporation the stock of which is traded on an established securities market) by an applicable specified affiliate (i.e., a domestic specified affiliate) thereof, in each case from persons other than (x) the covered corporation or another specified affiliate thereof or (y) the applicable foreign corporation or another specified affiliate thereof, respectively; and (7) repurchases by an applicable foreign corporation of its stock or purchases of the stock of such corporation by a specified affiliate thereof that is not an applicable specified affiliate thereof (i.e., by a foreign specified affiliate thereof) that is funded (e.g., by a distribution, debt, or a capital contribution) by an applicable specified affiliate thereof (i.e., by a domestic specified affiliate thereof) either (i) with a principal purpose of avoiding the excise tax, or, (ii) if such funding occurs other than by a distribution, within 2 years of such repurchase or purchase (in which case such principal purpose is deemed to exist). As mentioned above, the foregoing list of transactions that are treated as repurchases or economically similar to repurchases is exclusive. Therefore, no other transactions that do not constitute redemptions under section 317(b) are treated as repurchases subject to the excise tax.

The notice also provides a non-exclusive list of transactions that are not economically similar to a repurchase and therefore not subject to the excise tax. Specifically, the notice confirms that distributions in a complete liquidation of a corporation to which section 331 or section 332 (but not both) applies as well as a section 355 distribution other than a split-off (i.e., a spin-off) are not repurchases for purposes of the excise tax.

- Provides certain rules for applying the statutory exceptions of section 4501(e). First, the notice clarifies that the determination of whether the \$1 million de minimis exception applies (i.e., because the total fair market value of stock repurchased during the tax year does not exceed \$1 million) is made without regard to (i.e., before the application of) any other statutory exception and the netting rule. Second, the notice clarifies that the exception for reorganizations applies to the extent that the relevant corporation’s stock is exchanged for property permitted to be received under section 354 or 355 without recognition of gain or loss (i.e., generally, stock of a party to the reorganization or of a controlled corporation in the case of a section 355 split-off that does not occur pursuant to a divisive reorganization under section 368(a)(1)(D)). Thus, other property or money (i.e., “boot”) received by a shareholder in exchange for stock of a corporation subject to the tax in connection with a reorganization is generally subject to the excise tax. The notice further provides that the reorganization exception applies to section 355 split-offs, including those that do not occur pursuant to divisive reorganizations under section 368(a)(1)(D). Third, the notice clarifies that the exception for transfers of stock to an employer-sponsored retirement plan or similar plan (the “ESRP exception”) only applies to reduce the amount of repurchases subject to the excise tax by the amount of stock contributed to the plan during or on account of the same tax year. For such purposes, stock contributed to the plan prior to the deadline for filing the excise tax return with respect to stock repurchases for the tax year (i.e., the filing deadline for the first quarterly excise tax return after the close of the tax year, as discussed below) may be treated as contributed to the plan during the prior tax year. If stock contributed to the plan is of the same class as the stock repurchased during the tax year, the amount of the reduction under the statutory exception is based on the average fair market value per share of the stock repurchased during the taxable year (the aggregate fair market value of the stock repurchased during the year divided by the number of shares repurchased), multiplied by the number of shares contributed. However, if the stock contributed is not of the same class as the stock repurchased, the fair market value of the stock contributed to the plan is separately determined at the time of contribution. Fourth, the notice clarifies that the exception for securities dealers applies to repurchases by securities dealers in the ordinary course of such business, provided that the stock is accounted for as securities held for sale to customers in the ordinary course of such business, is disposed of within a time-period consistent with the ordinary course of such business and is not transferred to another securities dealer other than in a transaction in the ordinary course of business. Finally, the notice provides that there is a rebuttable presumption that the dividend exception does not apply to repurchases, which may be rebutted by showing that the relevant corporation (1) provided information reporting of the repurchase as a dividend to the shareholder, (2)

obtained certification from the shareholder that the repurchase was treated as a distribution under section 301 by reason of section 302(d) or had the effect of a dividend under section 356(a)(2), (3) had no knowledge of facts contrary to such shareholder certification, and (4) had sufficient earnings and profits to treat the repurchase as a dividend.

- Sets forth an exclusive list of issuances that are disregarded for purposes of the adjustment described in section 4501(c)(3), (d)(1)(C), or (d)(2)(C) (i.e., the reduction to the amount of repurchases subject to the excise tax for certain issuances during the same tax year under the netting rule). Specifically, the following stock is disregarded (and is not treated as issued or provided by the corporation) for purposes of applying the netting rule: (1) stock contributed to an employer-sponsored retirement or similar plan to which the ESRP exception applies; (2) stock withheld by the covered corporation or a specified affiliate thereof to satisfy its withholding obligations under sections 3402 or 3102; (3) stock withheld by the covered corporation or a specified affiliate to satisfy the exercise price of a stock option issued to an employee; (4) stock distributed by a corporation with respect to its stock; (5) stock issued to a specified affiliate of the corporation; (6) stock issued in an acquisitive reorganization, an E reorganization, an F reorganization, or a split-off to which the reorganization exception applies; (7) stock deemed issued in transactions to which section 304(a)(1) applies; (8) deemed issuances of fractional shares for which cash is paid (in lieu of such issuance) and not treated as repurchased (as described above); (9) stock issued by a dealer in securities in the ordinary course of business to which the securities dealer exception applies; and (10) target corporation stock issued to the merged corporation in exchange for consideration that includes the stock of the controlling corporation in a transaction qualifying as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(E). However, stock transferred to an employee or an unrelated third party due to an advance by such third party of the corporation's withholding obligation under sections 3402 or 3102 or of the exercise price of an option on behalf of an employee is treated as issued or provided by the corporation for purposes of the netting rule. As mentioned above, the foregoing list of issuances disregarded for purposes of the netting rule is exclusive. Therefore, all other issuances are treated as issuances for purposes of such rule. However, note that, under the statute, in the case of applicable foreign corporations and covered surrogate foreign corporations, only issuances to employees of the relevant applicable specified affiliate or expatriated entity thereof are taken into account for purposes of the netting rule. As discussed below, the notice also provides a special transition rule for the application of the netting rule with respect to fiscal year taxpayers during the tax year that straddles the effective date of the excise tax.

#### **KPMG observation**

Tax professionals note that the list of issuances disregarded for purposes of the netting rule appears to foreclose many of the avenues for netting rule planning previously considered (e.g., section 305 dividends, recapitalizations, issuances of hook stock, etc.). Notably, however, the notice does not identify a section 351 exchange with boot as a repurchase or as an economically similar transaction and does not disregard the issuance of stock by a transferee corporation in a section 351 exchange. As such, it appears that an acquisition of a target corporation that is implemented through a horizontal dummy structure utilizing a newly formed corporation ("Holdco") that qualifies under section 351(a) and (b), but not under section 368(a)(1)(A) by reason of section 368(a)(2)(E), would not be subject to the excise tax. Moreover, in such circumstance, the issuance of the Holdco stock in such section 351 contribution would not be disregarded for purposes of applying the netting rule with respect to Holdco in the tax year of the acquisition.

Also note that the excise tax consequences appear to differ between a fully taxable transaction versus an acquisitive reorganization. For example, in the case of a taxable merger involving no 80% corporate shareholder of the target corporation, the deemed liquidation of the target corporation would not be treated as a repurchase under section 3.04(4)(b)(i) of the notice.

Similarly, in a reverse triangular merger not qualifying as a reorganization under section 368(a)(1)(a) by reason of section 368(a)(2)(E) (for example, a reverse subsidiary merger with cash in excess of 20% of the total consideration), no amount of the target stock would be treated as repurchased (even though an amount of target stock equal to the cash component would be treated as repurchased if the transaction qualified under section 368(a)(1)(a) by reason of section 368(a)(2)(E)).

Moreover, as none of the statutory exceptions would apply in either of the foregoing cases, none of the merger consideration consisting of acquiring corporation stock would be disregarded as issued for purposes of the netting rule. Similarly, as noted above, deemed distributions in redemption of stock in taxable transactions to which section 304(a)(1) apply are not treated as repurchases subject to the excise tax, whereas the payment of boot consideration in acquisitive reorganizations may be treated as repurchases subject to the excise tax, notwithstanding that the payment of non-stock consideration in such transactions is economically similar. The reason for such disparate treatment is unclear. However, such disparity might be explained by the inherent difficulty in determining whether section 304(a)(1) applies to transactions between publicly traded corporations.

Other uncertainties are presented by the notice. For example, for purposes of the netting rule, it is unclear whether the transferor corporation and the resulting corporation in an F reorganization are treated as the “same corporation.”

Finally, the rules set forth in the notice provide limited protection for transactions involving special acquisition companies (“SPACs”). On the one hand, when a SPAC liquidates (e.g., due to failure to find a target within the requisite timeframe), the general exception from repurchase treatment for distributions in complete liquidations to which section 331 applies may preclude the liquidating distributions from being subject to the excise tax. On the other hand, however, voluntary redemptions in connection with de-SPAC transactions (i.e., in which a private company goes public via a merger with a SPAC) are repurchases subject to the excise tax.

Section 4 of the notice provides that the Treasury Department and IRS anticipate that the forthcoming proposed regulations will provide that the stock repurchase excise tax must be reported on Form 720 (Quarterly Federal Excise Tax Return). To facilitate the computation of the excise tax, the IRS also intends to issue an additional form that taxpayers will be required to attach to the Form 720 (as mentioned above, the IRS released a draft of Form 7208 for this purpose). Although Form 720 is filed quarterly, the Treasury Department and IRS expect the forthcoming proposed regulations to provide that the excise tax will be reported once per tax year on the Form 720 that is due for the first full quarter after the close of the taxpayer’s tax year. For example, a taxpayer with a tax year ending on December 31, 2023, would report its stock repurchase excise tax on Form 7208, to be attached to its Form 720 for the first quarter of 2024, due on April 30, 2024.

The Treasury Department and the IRS expect the forthcoming proposed regulations to provide that the deadline for payment of the excise tax is the same as the filing deadline, and that no extensions are permitted for reporting or paying the excise tax owed. Unlike for Section 3 of the notice, however, there is no statement in the notice that taxpayers can rely on the timing of payment rules in Section 4 until further guidance is issued. Hopefully, additional guidance regarding the timing of payments will be forthcoming prior to the end of the first quarter of 2023.

Section 5 of the notice provides that the Treasury Department and IRS anticipate that the forthcoming proposed regulations will provide that rules consistent with the rules described in section 3 of the notice generally apply to repurchases of stock of a covered corporation made after December 31, 2022, and to issuances of stock made during a tax year ending after December 31, 2022. Consistent with the foregoing effective date provision, the notice confirms the literal statutory application of the netting rule with respect to fiscal year taxpayers during the tax year that straddles the effective date of the excise tax. Specifically, in the case of such tax year of such taxpayers, the notice provides that, while the excise tax only applies to repurchases that occur during such tax year after December 31, 2022, issuances that occur at any time during such tax year (i.e., even those occurring prior to January 1, 2023) are taken into account for purposes of applying the netting rule.

In addition, the Treasury Department and IRS anticipate that the forthcoming proposed regulations will provide that rules consistent with the rules described in section 3.05(2)(a)(ii) of the notice apply to repurchases and acquisitions of stock of applicable foreign corporations made after December 31, 2022, that are funded by an applicable specified affiliate on or after December 27, 2022.

Section 6 of this notice requests comments on issues addressed in the notice as well as specific issues not so addressed.

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