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The Stock Buyback Excise Tax: Practical Considerations for Retirement Plans and Equity-Based Compensation Arrangements

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Legislation enacted in 2022 imposes a nondeductible, 1% excise tax (the ''excise tax'') on the net value of share repurchases by publicly traded domestic corporations (a ''covered corporation'') within a taxable year, effective with respect to repurchases on or after January 1, 2023.[1] For this purpose, a covered corporation is a domestic corporation, the stock of which is traded on an established securities market.[2] The covered corporation cannot avoid the excise tax by routing a repurchase through a controlled subsidiary entity — the tax extends[3] to purchases of stock by its ''specified affiliates,'' which include (A) any corporation more than 50% owned (by vote or by value), directly or indirectly, by the covered corporation, and (B) any partnership if more than 50% of the capital or profits interests of that partnership are held, directly or indirectly, by the covered corporation.[4]

In the domestic context, the value of stock repurchased by a covered corporation during a taxable year can be reduced by the value of stock issued, including stock issued or provided to an employee of the covered corporation or its specified affiliates (the ''netting rule'').[5] Thus, a publicly traded domestic corporation can get this adjustment with respect to stock-based compensation paid to its employees or the employees of its domestic and foreign subsidiary entities. In addition, there is a statutory exception for stock contributed to ''an employer-sponsored retirement plan, an employee stock ownership plan (ESOP), or similar plan.''[6]

The statute, while largely domestically focused, also applies to certain acquisitions of the stock of publicly traded *foreign* corporations. More specifically, if a foreign corporation has stock that is traded on an established securities market (such as a foreign corporation, an ''applicable foreign corporation''),[7] then any acquisitions of its stock by one of its domestic specified affiliates can be subject to the excise tax, with the tax imposed on the domestic specified affiliate, where the acquisition is from a person other than the foreign

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[1] Section 4501(a), enacted in §10201(a) of title I of a bill to provide for reconciliation pursuant to title II of S. Con. Res. 14 (better known as the Inflation Reduction Act), Pub. L. No. 117-169, 136 Stat. 1818, 1828–1831 (2022).

Unless otherwise indicated, all references in this article to the term ''section'' or ''§'' are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations thereunder.

[2] §4501(b). The definition incorporates by reference the §7704(b)(1) definition of an established securities market. The §7704(b)(1) regulations provide a definition that can be unexpectedly expansive and can pull in companies whose stock price is quoted in an interdealer quotation system that regularly disseminates firm buy or sell quotations. Reg. §1.7704-1(b).

[3] §4501(c)(2)(A).

[4] §4501(c)(2)(B).

[5] §4501(c)(3).

[6] §4501(e)(2).

[7] §4501(d)(3)(A). This definition employs the same reference to the §7704(b)(1) definition as it applies in the context of covered (domestic) corporations.

parent (or from a specified affiliate of the foreign parent corporation).[8] Notably, the netting rule is significantly more circumscribed in the inbound context — a specified affiliate that purchases stock of an applicable foreign corporation can only offset the value of "stock issued or provided by such specified affiliate to employees of the specified affiliate" for purposes of the netting rule (the netting rule as applied in the context of the purchase of stock of an applicable foreign corporation by a domestic specified affiliate, the "adjustment rule").[9]

On December 27, 2022, the IRS released Notice 2023-2 (the "Notice"), providing interim guidance on the new excise tax. The guidance, among other things, addresses the following: (1) how to determine the fair market value of corporate stock that is repurchased or issued or provided during the taxable year; (2) how to apply the adjustment under the netting rule, including rules that apply to covered corporations with taxable years beginning before January 1, 2023, and ending after December 31, 2022; (3) how to apply the exception for repurchased corporate stock that is contributed to an employer-sponsored retirement plan, ESOP, or similar plan; (4) how to treat stock withheld to cover the income tax of employees that were issued or provided corporate stock; and (5) the potential treatment of certain transactions as deemed repurchases of stock of an applicable foreign corporation by its domestic specified affiliates.

This article will address notable planning considerations and unanswered questions regarding the interplay between employer arrangements and the exemptions and/or adjustments related to the new stock buyback excise tax.[10] In addition, a more in-depth look is given to the effects of the excise tax on domestic corporations that purchase stock from their publicly traded foreign parent corporation (FP).

BACKGROUND

Public corporations commonly repurchase shares from the open market. The repurchase of corporate shares intrinsically strengthens the value of remaining shares by reducing the number of outstanding shares, thereby generally resulting in increased earnings per share. Other potential benefits include favorable tax treatment to certain shareholders, who generally receive capital gains tax treatment on redemption (including recovery of cost basis in the repurchased shares) rather than ordinary income on dividends. Further, stock buybacks may facilitate a range of capital market transactions beyond the basic buyback scenario, such as acquisitions by special purpose acquisition companies and other merger and acquisition transactions. Studies reflect that corporate stock repurchases rose significantly in recent years,[11] and it appears the new 1% excise tax may be a response to curb the utilization of corporate cash in this manner.[12]

ADJUSTMENTS — STOCK ISSUED OR PROVIDED

De Minimis Exception

The Notice provides certain rules for applying the statutory exceptions of §4501(e). It 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. For example, suppose in a taxable year, a covered corporation redeems $10,000,000 of its stock and issues or provides $9,500,000 of its stock to employees through a qualifying equity-based compensation (EBC) arrangement or through option exercises. In that case, the amount subject to the excise tax is reduced to $500,000, and the $500,000 amount is subject to the excise tax because the $1,000,000 *de minimis* threshold is tested before applying the netting rule.[13]

Netting Rule

The netting rule under §4501(c)(3) provides for an adjustment to the amount of repurchased stock by a

[8] §4501(d)(1). This provision applies to any acquisition of stock of an applicable foreign corporation by any specified affiliate other than (i) a foreign corporation or (ii) a foreign partnership that does have a domestic entity as a direct or indirect partner, where the acquisition is from a person other than the applicable foreign corporation (or a specified affiliate of the applicable foreign corporation). Curiously, this rule does not appear to extend to the purchase by a U.S. branch or a U.S. disregarded entity of an applicable foreign corporation.

The statute also provides special rules applying the excise tax in the context of "inversions" that occurred after September 20, 2021. §4501(d)(2). For simplicity, those rules are not a part of this discussion.

[9] §4501(d)(3)(C). There is no rule that would treat all members of a consolidated group as a single corporation; "separate entity treatment" appears to be the applicable rule.

[10] *See also* Adam Murphy, Maury Passman, and Jeffrey L. Vogel, *Stock Repurchases Under the Build Back Better Act's Excise Tax*, 175 Tax Notes Fed. 865 (May 9, 2022).

[11] *See* Jay B. Sykes, Cong. Rsch. Serv., Legal Sidebar, LSB10266, Stock Buybacks: Background and Reform Proposals (2019); Jane G. Gravelle, Cong. Rsch. Serv., IL11960, An Excise Tax on Stock Repurchases and Tax Advantages of Buybacks Over Dividends (2022).

[12] Press Release, Brown, Wyden, Unveil Major New Legislation To Tax Stock Buybacks (Sept. 10, 2021), Finance Committee Chair Ron Wyden (D-Or.) remarks on the Senate floor.

[13] *See* Notice 2023-2, §3.03(2)(b)(i) and (ii).

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covered corporation, whereby the aggregate fair market value of stock repurchased and taken into account for purposes of the excise tax is reduced by the fair market value of any stock issued or provided by the covered corporation during the taxable year, including the fair market value of any stock issued or provided to employees of a covered corporation (or employees of a specified affiliate of such covered corporation), whether or not such stock is issued pursuant to the exercise of an option.[14]

Fair Market Value and Date of Determination

In general, the stock's fair market value for netting rule purposes is its market value on the date of transfer to a covered employee. Stock is transferred under §4501 when it is issued or provided. The terms ''issued'' or ''provided'' are not explicitly defined in the statute. However, the Notice treats stock as issued or provided by a covered corporation to an employee on the date the employee is ''treated as the beneficial owner of the stock for [f]ederal income tax purposes.''[15] In general, an employee is treated as the beneficial owner of stock when the stock is substantially vested within the meaning of Reg. §1.83-1(b).[16]

Adjustment Considerations With Common EBCAs

Stock Options

Nonqualified Stock Options (NSOs) are a form of equity-based compensation providing a participant with the right to purchase a set number of company shares at a pre-determined strike/exercise price. NSOs are generally settled in shares upon exercise. The stock's fair market value for adjustment purposes is typically determined on the date the stock is issued or provided to the employee, which generally is the date the employee exercises the option.[17]

Stock Appreciation Rights (SARs)

SARs are a form of equity-based compensation that provides a participant with the right to the appreciation of a set number of a corporation's shares for a pre-determined period. SARs are often designed to be settled in cash or actual shares. The Notice provides the same outcome for SARs as NSOs. The fair market value of stock for adjustment purposes is determined on the date the SARs are issued or provided to the employee, generally the day the employee exercises the SARs.[18] Companies with SARs may consider settling such arrangements with covered corporation stock upon settlement rather than cash to reduce the excise tax (under the netting rule).

Incentive Stock Options (ISOs)

Like NSOs, ISOs permit employees with the right to purchase a set number of the company's shares at a pre-determined strike/exercise price but generally defer employee recognition until the disposition of shares acquired through the exercise. The Notice provides that stock transferred to an employee pursuant to an ISO exercise is issued or provided to the employee on the date the employee exercises the option.[19] The stock's fair market value for adjustment purposes is determined on such date.

Employee Stock Purchase Plans (ESPPs)

ESPPs permit employees to purchase company shares over a specified period, generally at a discounted price. The shares are treated as issued or provided to an employee on the stock purchase date of an ESPP. The Notice suggest that the fair market value for adjustment purposes will be the value of the stock on the stock purchase date of the ESPP.[20]

Restricted Stock Units (RSU) and Performance Stock Units (PSUs)

RSUs and PSUs generally are contractual promises to transfer stock or cash in the future following the satisfaction of vesting conditions. The Notice provides that stock transferred pursuant to a vested stock award or restricted stock unit is issued or provided when the covered corporation (or its specified affiliate) initiates payment of the stock. RSUs/PSUs are not instantly transferred once an employee satisfies the vesting conditions. Instead, the corporation may notify its transfer agent to transfer the shares (or may transfer the shares themselves) to the employee to sat-

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[14] As noted elsewhere in this article, this adjustment is limited in the context of subsidiaries of publicly traded foreign corporations.

[15] *See* Notice 2023-2, §3.08(3)(b)(i). *Also see* GLAM 2020-004, which discusses the date that an employee is to be treated as acquiring a beneficial interest in shares in the context of stock options, stock-settled stock appreciation rights, and stock-settled restricted stock units.

[16] *See Miller v. United States*, 345 F. Supp. 2d 1129, 1133 (W.D. Wash. 2005) defines a beneficial owner as an individual without legal title to the property but has rights in the property that are the normal incidents of owning property (i.e., right to receive dividends, right to vote the shares, right to dispose of the shares, and right to use the shares as collateral). *See also Miami Nat'l Bank v. Commissioner*, 67 T.C. 793 (1977); *Grodt & McKay Realty, Inc. v. Commissioner*, 77 T.C. 1221 (1981); *Anschutz Co. v. Commissioner*, 664 F.3d 313 (10th Cir. 2011).

[17] *See* Notice 2023-2, §3.08(3)(b)(ii).

[18] *Id.*

[19] *Id.*

[20] *See id.*, §3.08(3)(c).

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isfy the corporation's obligations under the RSUs/PSUs. However, there may be a delay between the notification to transfer the shares and the actual transfer of the shares. Thus, the Notice clarifies that the date the stock is treated as issued or provided to the employee is the date that the payment is initiated, and thus the fair market value for adjustment purposes will be the market value of the shares on that date. This point is further illustrated in Example 24 in the Notice:

> *Example 24: Vested stock provided to an employee with share withholding* — (a) Facts. Employee N is an employee of Corporation X. In 2024, as compensation for Employee N's services, Corporation X grants Employee N 100x restricted stock units (RSUs). Pursuant to the RSUs, if Employee N remains employed by Corporation X through December 31, 2026, Corporation X will transfer 100x shares of Corporation X stock to Employee N in January 2027. Employee N remains employed by Corporation X through December 31, 2026. In January 2027, when the shares have a fair market value of $50x per share, Corporation X initiates the transfer of 60x shares of Corporation X stock to Employee N and withholds 40x shares to satisfy its income tax and employment tax withholding obligations.
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> (b) Analysis. 60x shares of Corporation X stock are treated as issued or provided to Employee N when the shares are transferred in 2027. See section 3.08(3)(a)(ii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2027 taxable year is reduced by $3,000x (60x shares × $50x per share = $3,000x).[21]

Accordingly, companies may consider settling such arrangements with covered corporation stock upon settlement rather than cash if the desire is to reduce the excise tax under the netting rule.

Restricted Stock

Restricted stock is another common equity-based incentive. Restricted stock involves the transfer of shares to a participant subject to restrictions (shares received by the participant generally are non-transferrable by the participant until vested). If the restricted shares are forfeited (do not vest according to the terms of the arrangement), the restricted shares revert to the employer. If permitted under the relevant arrangement, an employee may make a §83(b) election to include in gross income the difference between the fair market value of the restricted stock and the amount paid (usually zero) at the date of grant/transfer[22] which, under subsequent guidance,[23] generally results in the recipient being treated as the owner of the shares on receipt for tax purposes.

The Notice provides that if an employee makes a §83(b) election, the restricted stock will be considered issued or provided to the employee on the date of transfer.[24] The stock's fair market value for purposes of the netting rule will be the market value of the restricted stock on the date of transfer.[25] This point is illustrated in Example 23 in the Notice:

> *Example 23: Restricted stock provided to employee with §83(b) election* — (a) Facts. The facts are the same as in section 3.09(22) of this notice (Example 22), except that Employee M elects under §83(b) to include the fair market value of the shares of restricted stock in gross income when the shares are transferred.
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> (b) Analysis. 100x shares of Corporation X stock are treated as issued or provided to Employee M when the shares are transferred in 2024. See section 3.08(3)(b)(iii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2024 taxable year is reduced by $5,000x (100x shares × $50x per share = $5,000x). No shares of Corporation X stock are treated as issued or provided to Employee M when the shares vest in 2027.[26]

In contrast, if a §83(b) election is not made, the restricted stock is not considered issued or provided until it becomes substantially vested within the meaning of Reg. §1.83-3(b), and the fair market value for purposes of the netting rule will be the market value as of that date.[27] This point is illustrated in Example 22 of the Notice:

> *Example 22: Restricted stock provided to employee* — (a) Facts. Employee M is an employee of Corporation X. In 2024, as compensation for Employee M's services, Corporation X transfers to Employee M 100x shares of Corporation X re-

[21] *See id.*, §3.09(24) *Ex.* 24.

[22] §83(b).

[23] *See* GLAM 2020-004.

[24] *See* Notice 2023-2, §3.08(3)(b)(iii). Under §83(b)(2), an election can be made within 30 days of the transfer of restricted stock to the employee. Thus, an employee can wait 30 days after the transfer to decide whether to make the election. However, here the taxable event is the transfer date if the election is made.

[25] *See id.*, §3.08(3)(c), which provides that the value of stock issued or provided to an employee is the value of the stock, as determined under §83, as of the date the stock is issued or provided.

[26] *See id.*, §3.09(23) *Ex.* 23.

[27] *See id.*, §3.08(3)(b)(i), (c).

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stricted stock, when the fair market value of each share is $50x. The shares vest in 2027. Employee M does not make an election under §83(b). In 2027, when the shares vest, the shares have a fair market value of $70x per share. In 2027, Corporation X withholds from Employee M's other wages amounts that are required to pay its income tax and employment tax withholding obligations arising from the stock transfer.

(b) Analysis. 100x shares of Corporation X stock are treated as issued or provided to Employee M when they become substantially vested in 2027. See section 3.08(3)(b)(i) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2027 taxable year is reduced by $7,000x (100x shares × $70x per share = $7,000x).[28]

The Notice's discussion of stock options assumes that the options are vested; however, it does not address the early exercise of options, which may result in participants holding restricted stock. Guidance to address this situation would be welcome.

EXEMPTIONS — RETIREMENT PLANS, ESOPs, AND SIMILAR PLANS

Section 4501(e) sets forth several exemptions, which provide, among other things, that the excise tax does not apply to the extent that the repurchased stock (or an amount of stock equal to the value of the stock repurchased) is ''contributed to an employer-sponsored retirement plan, employee stock ownership plan [ESOP], or similar plan.''[29]

In general, the Notice confirms that repurchased stock contributed to an employer-sponsored retirement plan, ESOP, or similar plan reduces the covered corporation's repurchase stock tax liability (or stock repurchase excise tax base) by the fair market value of the stock contributed.[30] The Notice, however, appears to limit the exemption to qualified retirement plans under §401(a).[31] In particular, the statute uses the phrase ''employer-sponsored retirement plan, employee stock ownership plan, or similar plan,'' but does not define any of these terms. The Notice, in §3.03(12), defines the term ''employer-sponsored retirement plan'' as ''a retirement plan maintained by a covered corporation that is qualified under §401(a), including an employee stock ownership plan described in §4975(e)(7).'' The Notice does not purport to define the term ''employee stock ownership plan'' as that term is used in §4501(e)(2), though presumably this is a drafting nicety and the reference to §4975(e)(7) in the Notice's definition of ''employer-sponsored retirement plan'' is intended to be relevant. The Notice also does not purport to define what might constitute a ''similar plan,'' an issue discussed below. The Notice invites taxpayers to comment on this open question.[32]

Repurchased stock contributed to an employer-sponsored retirement plan, ESOP, or similar plan does not have to be the same shares or class of stock the covered corporation repurchased. In the case of a contribution of shares of the same class of stock, as stock repurchased, the amount by which repurchases are reduced is determined by the aggregate fair market value of repurchased shares of such class divided by the total number of repurchased shares of such class during the tax year (i.e., the average price of repurchased shares of such class). The average price of the repurchased class of shares is then multiplied by the number of shares contributed. This point is illustrated in Example 20 in the Notice:

Example 20: Multiple repurchases and contributions of same class of stock — (a) Facts. On January 15, 2023, Corporation X repurchases 100x shares of its Class A stock that have an aggregate fair market value of $1,000x. Corporation X repurchases 50x shares of its Class A stock on September 15, 2023, that have an aggregate fair market value of $200x. Corporation X contributes to its employee stock ownership plan 75x shares of its Class A stock on March 15, 2023, and 75x shares of its Class A stock on October 15, 2023.

(b) Analysis. The amount of the reduction to Corporation X's stock repurchase excise tax base is determined by dividing the aggregate fair market value of shares of Class A stock repurchased by the number of shares repurchased ($1,200x/150x shares = $8/share) and multiplying the number of shares contributed by the average price of repurchased shares (150x shares × $8/share = $1,200x). See section 3.07(3)(c)(i) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2023 taxable year is $0 ($1,200x repurchase − $1,200x exception = $0).[33]

However, if the repurchased shares are of a different class of stock than the shares contributed, the re-

[28] *See id.*, §3.09(22) *Ex.* 22.

[29] §4501(e)(2).

[30] *See* Notice 2023-2, §3.07(3), which provides the general application of repurchased corporate stock contributed to an employer sponsored retirement plan, ESOP, or similar plan.

[31] *See id.*, §3.02(12). The Notice defines the term ''employer-sponsored retirement plan'' rather than the full phrase used in §4501(e)(2): ''employer-sponsored retirement plan, employee stock ownership plan, or similar plan.''

[32] *See id.*, §6.01(4).

[33] *See id.*, §3.09(20) *Ex.* 20.

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duction is the aggregate fair market value of the shares contributed at the time of contribution; however, such amount may not exceed the fair market value of the repurchased stock. This point is illustrated in Example 21 in the Notice:

> *Example 21: Multiple repurchases and contributions of different class from repurchased shares* — (a) Facts. On January 15, 2023, Corporation X repurchases 100x shares of its Class A stock that have an aggregate fair market value of $1,000x. Corporation X repurchases 50x shares of its Class A stock on September 15, 2023, that have an aggregate fair market value of $200x. Corporation X contributes to its employee stock ownership plan 75x shares of its Class B stock on October 15, 2023, that have an aggregate fair market value of $1,000x. Corporation X contributes to its employee stock ownership plan 25x shares of its Class B stock on December 15, 2023, that have an aggregate fair market value of $500x.
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> (b) Analysis. The amount of the reduction to Corporation X's stock repurchase excise tax base is equal to the sum of the fair market values of the different class of stock at the time that the stock is contributed to the employer-sponsored retirement plan ($1,000x + $500x = $1,500x). However, the amount of the reduction must not exceed the aggregate fair market value of stock of a different class repurchased during the taxable year by Corporation X (that is, $1,200x). See section 3.07(3)(c)(ii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2023 taxable year is $0 ($1,200x repurchase – $1,200x exception = $0).[34]

Further, contributions of repurchased stock to an employer sponsored retirement plan, ESOP, or similar plan must occur during the covered corporation's taxable year to reduce the stock repurchase excise tax base. However, for purposes of the excise tax, a covered corporation may treat contributions made after the close of a tax year as having been contributed in the prior tax year if contributed by the filing deadline for IRS Form 720, *Quarterly Federal Excise Tax Return*.[35]

WITHHOLDING: SELL-TO-COVER VS. NET EXERCISE

Companies generally are required to withhold payroll taxes when employees recognize income on EBC arrangements. Similarly, many employers offer option arrangements whereby employees can ''net exercise'' their stock options, which allows for the use of some of the shares covered by an option to pay for the option exercise price. Companies and employees often fund payroll tax withholding on EBC arrangements and exercise price payments through net exercise or sell-to-cover arrangements.

Net Exercise

With net exercise arrangements, companies may retain shares from the shares to be awarded to employees with a value equal to the payroll tax withholding liability or the aggregate exercise price of the exercised options. In this manner, a net exercise arrangement does not result in the retained shares becoming outstanding, or it might be viewed as though the retained shares were first provided to the employee and then reacquired by the issuing corporation. In either event, only the net value of shares provided to the employee ought to count for purposes of the excise tax. Unsurprisingly, the Notice provides that shares retained in a net exercise arrangement are not considered issued or provided[36] and thus do not qualify for an adjustment under the netting rule for excise tax purposes. This is illustrated in Example 25 in the Notice:

> *Example 25: Stock option net exercise* — (a) Facts. Employee O is an employee of Corporation X. In 2024, Corporation X transfers to Employee O options to purchase 100x shares of Corporation X stock with an exercise price of $40x per share. The options are described in §1.83-7 and do not have a readily ascertainable fair market value. Employee O exercises the option to purchase 100x shares in 2025 when the fair market value is $50x per share. Corporation X withholds 80x shares to pay the exercise price.
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> (b) Analysis. 20x shares of Corporation X stock are treated as issued or provided to Employee O when the options are exercised in 2025. See section 3.08(3)(a)(iii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2025 taxable year is reduced by $1,000x (20x shares × $50x per share = $1,000x).[37]

It is important to note that ISOs are not normally net exercised as they may lose their preferential tax treatment.

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[34] *See id.*, §3.09(21) *Ex.* 21.

[35] *See id.*, §3.07(3)(d). The filing deadline generally is the due date for the Form 720 that is due for the first full calendar quarter following the end of the taxpayer's taxable year. *Id.*, §4.

[36] *See id.*, §3.08(3)(a)(ii).

[37] *See id.*, §3.09(25) *Ex.* 25.

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Sell-to-Cover

Alternatively, companies and employees may look to fund payroll tax withholdings through a sell-to-cover arrangement. In a sell-to-cover arrangement, shares are actually transferred to employees' brokerage accounts. In turn, the brokerage sells enough shares to cover the withholding tax liability, and the proceeds are then sent to the company to cover the payroll tax withholding liability. Unlike a net exercise arrangement, shares of a covered company issued in a sell-to-cover arrangement per Notice 2023-2 qualify for the adjustment calculation because the shares are actually issued and outstanding on the public market.[38] Using Example 25 above, the 80 shares that were withheld, by contrast, in a sell-to-cover arrangement, would transfer to the employee. Thus, the entire 100 shares, instead of 20, would be treated as issued or provided to Employee O. Consequently, a sell to cover arrangement allows for a more considerable reduction of the repurchase excise tax base than a net exercise arrangement.[39]

SPECIAL CONSIDERATIONS FOR FOREIGN PARENTED MULTINATIONALS

At first glance, the statutory rules might not be expected to be particularly problematic for inbound companies; U.S. subsidiary entities generally do not undertake large-scale purchases of the stock of their publicly traded foreign parents. However, the operation of these rules in the context of EBCAs of foreign-parented multinationals is not so simple and can raise several issues. Consider the following examples, where a foreign parent corporation (FP) has outstanding stock publicly traded on FP's home country's national securities exchange, FP directly owns all the stock of a domestic corporation (US1), a pure holding company, and US1 owns all of the stock of a domestic subsidiary corporation (US2) with significant business operations and payroll, and US1 and US2 file a consolidated U.S. federal income tax return.

> *Example 1*: In 2023, US2 provides FP stock to one of its employees upon the employee's exercise of a stock option. The stock is not subject to the risk of forfeiture. To provide for the stock, US2 purchases FP's stock on the foreign exchange.

In Example 1, the first observation is that US2's purchase of the FP stock in 2023 is potentially subject to the excise tax under §4501(d)(1) because US2 purchased the FP stock on the exchange, presumably from an unrelated seller. The second observation is that the stock is considered issued or provided by US2 to its employee in 2023. Therefore, the adjustment rule applies for 2023.

> *Example 2*: The facts are the same as in Example 1, except that US2 purchases the FP stock directly from FP.

In Example 2, the first observation is that US2's purchase of the FP stock from FP generally should not be subject to the excise tax. Under §4501(d)(1), the excise can apply where the FP stock is purchased from a person who is not the applicable foreign corporation (FP) or a specified affiliate of such applicable foreign corporation. In the example, the stock is acquired directly from FP and thus is not within this rule. This no-tax result is consistent with the Notice.[40] The second observation is that the stock is considered issued or provided by US2 to its employee in 2023. Therefore, the adjustment rule applies for 2023 to the extent it might be needed with respect to some other purchase.

> *Example 3*: The facts are the same as in Example 1, except US1 (rather than US2) purchases the FP stock on the exchange.

Here, as in Example 1, the purchase of the FP stock in 2023 is potentially subject to the excise tax under §4501(d)(1) because US1 purchased the FP stock on the exchange, presumably from an unrelated seller. However, unlike Example 1, the adjustment rule is not expected to apply because the regarded entity that purchased the FP stock (US1) did not provide the FP stock to its employee. In particular, the relevant statutory adjustment rule for inbound taxpayers applies only to stock provided "by such specified affiliate to employees of the specified affiliate"[41] and thus shares purchased by a specified affiliate for the benefit of employees of a different affiliate (including, potentially, a subsidiary filing a consolidated tax return with the specified affiliate), literally do not qualify for the adjustment rule.

Note that if US1 were to purchase the FP shares on the exchange under an agreement pursuant to which US1 is acting as the agent of US2, it might be possible to argue that for U.S. tax purposes, the purchase ought to be treated as having been made by US2, thus clearing the way for the potential application of the adjustment rule.

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[38] *See id.*, §3.08(3)(a)(iv).

[39] *See id.*, §3.09(26) *Ex.* 26.

[40] *See id.*, §3.05(1) and (2)(a)(i). This assumes that FP did not repurchase its stock on the exchange as an agent (or conduit) for US2.

[41] §4501(d)(1)(C).

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Example 4: The facts are the same as in Example 1, except that in 2023, US2 provides an option to its employee to acquire a share of FP stock, and on the same date, US2 purchases a share of FP stock on the exchange (which it contributes to a trust established by FP in its home country and viewed as a grantor trust of FP under U.S. tax principles). In 2024, the employee exercises the option, and the FP share is provided to the employee.

Here, as in Example 1, the purchase of the FP stock in 2023 is potentially subject to the excise tax under §4501(d)(1) because US2 purchased the FP stock on the exchange, presumably from an unrelated seller. However, the adjustment rule is not expected to apply in 2023 as to the stock provided to the employee because the FP stock is not provided to the employee in 2023. Instead, the FP stock is provided to the employee in 2024, and the adjustment rule can apply in that year to reduce the value of any FP stock acquired by US2 in that year.

Example 5: In 2023, US2 grants a stock-based stock award to one of its employees. The stock award is subject to a substantial risk of forfeiture, and the employee does not make a section 83(b) election. On the same date, US2 purchases FP's stock on the foreign exchange, which contributes to an employee benefit trust established by FP for use by FP and its subsidiaries for employee compensation purposes. The stock award vests in 2024.

Here, as in Example 1, US2's purchase of the FP stock in 2023 is potentially subject to the excise tax under §4501(d)(1) because US2 purchased the FP stock on the exchange, presumably from an unrelated seller. The second observation is that the stock is not considered issued or provided to US2's employee in 2023 — there is no §83(b) election, the award has not vested, and the employee is not treated for U.S. federal income tax purposes as owning the underlying stock.[42] Therefore, the adjustment rule has no potential application for 2023.

The third observation is that while the statute provides an exception to the excise tax for contributions to "an employer-sponsored retirement plan, employee stock ownership plan, or similar plan," the phrase is not defined in §4501, and its scope is thus uncertain. As discussed above, the Notice defines the term "employer-sponsored retirement plan" as "a retirement plan maintained by a covered corporation that is qualified under §401(a), including an employee stock ownership plan described in §4975(e)(7)." This definition would be of no help to US2 with respect to the employee benefit trust established by FP for use by FP and its subsidiaries. This is in part because FP, as a foreign entity, is not a "covered corporation" and thus cannot maintain such a plan. Additionally, the requirement that the plan be qualified under §401(a) suggests that the relevant plans are limited to trusts that are created or organized in the United States. The term "employee stock ownership plan" might reasonably be presumed to have the meaning assigned in §409(a) or §4975(e)(7). This, too, may be unavailing to FP and US2 because both of those definitions similarly require the plan to be qualified under §401(a). Finally, there is the question as to whether the employee benefit trust established by FP for use by FP and its subsidiaries might constitute a "similar plan" within the meaning of §4501(e)(2). The Notice appears intended to limit the §4501(e)(2) exception to contributions to plans qualified under §401(a), likely rendering the statutory exception inapplicable in the above example and leaving potential excise tax exposure for 2023. Presumably, the adjustment rule can apply in 2024 to reduce the value of any FP stock acquired by US2 in that year.

Example 6: The facts are the same as in Example 1, except that FP purchases its stock on the exchange, and through a chargeback mechanism, FP is reimbursed by US2.

This example raises the question of whether US2 should be treated as having purchased the FP stock on the exchange, with FP acting as US2's agent (or as a conduit) for such a purpose.[43] If so, the analysis would seem the same as in Example 1.

Example 7: The facts are the same as in Example 1, except that US2 purchases a total of $850,000 of FP stock in 2023. In addition, during 2023, FP repurchases $100 million of its stock, none of which is treated as having been purchased by US2.

This example is intended to illustrate the *de minimis* rule in §4501(e)(3). The statute suggests that in the context of inbound taxpayers, the *de minimis* rule is to be applied by looking solely at the specific regarded U.S. subsidiary entity that undertook the acquisition of FP stock, and this is determined by looking to the gross value of stock acquired without regard to the adjustment rule or other exceptions. This view seems consistent with §3.03(2) of the Notice.

Example 8: The facts are the same as in Example 7, except that US2 purchases a total of $1.1 million

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[42] This is consistent with the timing rules in the Notice.

[43] This discussion does not address deemed acquisitions of foreign parent stock by U.S. subsidiary entities under the expansive "funds by any means" and *per se* funding rules in §3.05(2)(a)(ii)(A) and (B) of the Notice.

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of FP stock in 2023 and provides $300,000 of the stock to its employees.

In Example 8, the gross value of US2's purchases of FP stock (prior to the application of the adjustment rule) exceeds the $1 million threshold. Thus, the statutory exception does not apply. Instead, US2 is potentially subject to the excise tax on the full $1.1 million of FP stock acquired, reduced by the $300,000 provided to its employees. As illustrated in this example, the $1 million *de minimis* threshold operates as a cliff, not an exemption, and is measured on a gross basis.

Additional Observations

In assessing any potential exposure, there are a series of issues. First, has there been an acquisition of the foreign parent's stock by a U.S. subsidiary entity?[44] If there has been such an acquisition, what is the date of the acquisition, and what is the value of the acquired stock? Second, as to the application of the adjustment rule, there are questions as to whether and when the shares are "provided" to employees of the specified affiliate and the value of those shares. Third, as to the application of the statutory exception for contributions to a plan, whether the plan qualifies as a "similar plan," and if so, when are the shares provided to such plan, and what is the value of those shares?

While the above illustrates the significant potential complexity (and administrative burden) of applying the applicable foreign corporation rules in the context of employee compensation arrangements, in many cases, the ultimate excise tax liability resulting from these issues may be relatively small.[45]

However, the Notice also indicates that the government intends to provide rules that would greatly expand the reach of the excise tax in the context of foreign-parented multinational groups. In general terms, the Notice includes potential (and controversial) rules that would treat a U.S. subsidiary entity as purchasing its foreign parent's stock if the U.S. subsidiary entity "funds by any means" the parent's purchase of its stock, and such funding was done with a principal purpose to avoid the excise tax. Further, the Notice would presume any such funding was made with such a principal purpose if the funding were to occur within two years of the foreign parent's repurchase of its stock.[46] A discussion of this funding rule is not included in this article.[47] However, it is worth pointing out that if the funding rule is retained in temporary or final regulations, the effect of that rule on employee compensation arrangements would add an additional layer of complexity.

As to compliance matters, the Notice states that reporting of the excise tax would be due once a year on a form attached to the Form 720 for the first full calendar quarter after the end of the taxable year.[48] The tax would be payable on the same date.[49] Thus, for calendar year taxpayers and their 2023 taxable years, this refers to the Form 720 that would be due on April 30, 2024. The IRS has released a draft of Form 7208, *Excise Tax on Repurchase of Corporate Stock*,[50] which would be the form on which repurchases are reported. Taxpayers can review the current draft of Form 7208 to get a sense of the information the IRS will require to be reported and can socialize these information requests with the various internal departments (such as legal, treasury, HR, investor relations, etc.) so that this data can be captured well in advance of the filing date.

CONCLUSION

The new stock buyback excise tax should be considered by public corporations repurchasing stock (whether as part of a plan, transaction, etc.). Aside from general corporate matters, there are specific considerations related to equity-based compensation arrangements and retirement plans (including, but not limited to, the funding of payroll withholding taxes). Regarding equity compensation, the Notice 2023-2 approach aligns conceptually with §83 and GLAM 2020-004. Such alignment reduces the need for duplicative and differing efforts and is likely welcomed by taxpayers. Although the Notice is 52 pages long with 26 examples covering several topics, questions remain on the application of the excise tax. Treasury and the IRS anticipate such and have requested comments on initial rules set forth in the Notice as well as additional areas of future guidance.

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[44] The answer to this question could be significantly affected by whether the expansive "funds by any means" and *per se* funding rules in §3.05(2)(a)(ii)(A) and (B) of the Notice are contained in regulations, and if so whether exceptions are provided for certain ordinary course and short-term funding transactions.

[45] We note that the Biden Administration's FY2024 Budget Proposals would increase the excise tax rate from one to four percent, effective with respect to stock purchases on or after January 1, 2023. *See* KPMG discussion on the Greenbook here (FY 2024 budget: "Green Book" — KPMG United States).

[46] *See* Notice 2023-2, §3.05(2)(a)(ii)(A) and (B).

[47] *But see* KPMG report: Stock repurchase excise tax and funding rule considerations for inbound taxpayers for further discussion on the funding rule.

[48] *See* Notice 2023-2, §4.

[49] *Id.*

[50] A draft of Form 7208 may be found at https://www.irs.gov/pub/irs-dft/f7208--dft.pdf.

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