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Treasury's Stock Buyback Rule Offers Corporations Little Clarity

By Timothy Nichols

- *KPMG's Timothy Nichols analyzes proposed tax regulations*
- *Proposal raises same concerns that 2022 guidance created*

If the Treasury Department finalizes regulations proposed earlier this month addressing the 1% excise tax on corporate stock repurchases without any changes, foreign-parented multinational groups likely would face significant challenges in determining their excise tax liability.

Perhaps the most notable—and possibly controversial—aspect of the recent proposed regulations is the new funding rule that would apply to certain US subsidiaries of publicly traded foreign corporations. The funding rule appears to subject a far broader range of transactions to the excise tax than the relevant statutory rule, making it difficult to determine exactly which transactions are subject to the excise tax.

However, practitioners should know the proposed regulations provide that no stock repurchase excise tax filings are required, and no payments need to be made, until after the Treasury publishes its final excise tax regulations.

As background, the stock buyback excise tax generally is imposed on repurchases by publicly traded domestic corporations. For publicly traded foreign corporations, under the statutory language, the excise tax is imposed only on certain purchases of foreign corporation stock by its US subsidiaries and in the context of certain inversion transactions (where a foreign corporation acquires a US entity, and the entity's former owners receive a large percentage of the foreign corporation's stock).

Interim guidance on the excise tax released in December 2022 included a funding rule that would have applied the excise tax to certain US subsidiaries of a publicly traded foreign parent if those subsidiaries funded a purchase of foreign-parent stock by the foreign parent (or another foreign affiliate).

The interim guidance also included a per se rule that a funding by any means other than a distribution within two years of a purchase would be treated as funding that purchase—and likely cause the funding to be subject to the excise tax.

The proposed regulations, published April 12, would replace the per se rule with a new rule that appears to create many of the same issues and uncertainties that led to criticism of the interim guidance. As a result, foreign-parented multinationals, and their US subsidiaries, shouldn't assume that proposed regulations solve the issues that were raised by the interim guidance in December 2022.

At a high level, the proposed regulations appear to state that if a US subsidiary funds by any means, directly or indirectly, its foreign parent (or a related foreign entity) with a principal purpose of funding a

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purchase of the foreign parent's stock, that US subsidiary is treated as having a purpose of avoiding, and generally is subject to, the excise tax.

However, most purchases of publicly traded stock are done by the issuer of that stock rather than a subsidiary for reasons that have nothing to do with the excise tax. So it appears questionable to equate an intent to fund a stock purchase with an intent to avoid the excise tax.

Given the fungibility of cash, it's also not clear how to evaluate the purpose of a particular funding in the context of a typical multinational group, where cash frequently moves between various entities for various purposes.

While domestic corporations generally may offset stock issuances against repurchases when calculating their excise tax liability, the ability to offset issuances against repurchases is far more limited in the context of a foreign-parent group. Therefore, despite the statute's focus on publicly traded domestic corporations, publicly traded foreign corporations would appear to have significant excise tax exposure under the rules in the proposed regulations.

Taxpayers subject to the excise tax should be aware that most preferred stock, even preferred stock with more debt-like terms, would be considered for purposes of the excise tax, both on repurchase and issuance.

The proposed regulations don't allow stock issuances to be carried forward if they exceed repurchases in a given year. As a result, the timing of issuances and repurchases should be considered in certain cases.

For example, if a large stock issuance by a covered corporation occurs at the end of one tax year and a large repurchase at the beginning of the next tax year (or vice versa), there generally is no ability to offset the issuance against the repurchase for excise tax purposes. However, such an offset generally would be allowed if the issuance and repurchase occur in the same tax year.

The proposed regulations also would apply special rules to non-stock instruments, meaning instruments that don't legally constitute stock but that are treated as stock for federal income tax purposes.

These rules, which weren't in the December 2022 interim guidance, affect the timing of when non-stock instruments are considered as issuances and can limit the amount of the issuance for excise tax purposes.

While the preamble to the proposed regulations states that these rules were necessary to prevent abusive transactions, the purported abuse seems unlikely to exist in practice. Meanwhile, these broad rules would affect any non-stock instruments regardless of whether any abuse was intended.

Taxpayers, particularly foreign parented multinationals should be aware of the potential impact of these proposed changes and consider submitting comments to Treasury before June 11, the deadline for submission.

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