
LEGAL UPDATES AND NEWS

New Tax on Stock Repurchases

On August 16, 2022, the Inflation Reduction Act (the “Act”) was signed into law. The Act includes a new non-deductible 1% excise tax on corporate stock repurchases, effective for stock repurchased after December 31, 2022. Under the new Section 4501 of the Internal Revenue Code, an excise tax equal to 1% of the fair market value of any stock of a covered corporation that is repurchased by the corporation (or an affiliate) during the taxable year will be imposed.¹

The Act defines a “covered corporation” as a domestic corporation the stock of which is traded on an established securities market, such as Nasdaq or the New York Stock Exchange, or on an interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise, such as OTCQX, OTCQB and Pink Markets.

The Act contains certain exceptions and adjustments that may reduce or potentially eliminate the amount of tax imposed under Section 4501:

- The amount subject to the excise tax is reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including stock issued or provided to employees of the covered corporation or a specified affiliate during the taxable year, such as the granting of restricted stock awards or stock issued upon the exercise of stock options.
- The excise tax does not apply if the total value of the stock repurchased during the taxable year does not exceed \$1 million.
- The excise tax does not apply to the extent that the stock repurchased is part of a tax-free reorganization (within the meaning of Section 368(a) of the Internal Revenue Code) and no gain or loss is recognized by the shareholder by reason of the reorganization.
- The excise tax does not apply to any stock repurchased if such shares are contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan.
- The excise tax does not apply to stock repurchases by a dealer in securities in the ordinary course of business.
- The excise tax does not apply to stock repurchases by a regulated investment company or a real estate investment trust.

¹ For purposes of the new Internal Revenue Code Section 4501, an “affiliate” means, with the respect to the covered corporation, (i) any corporation more than 50% of the stock of which is owned (by vote or by value) by the covered corporation, or (ii) any partnership more than 50% of the capital interests or profits interests of which is held by the covered corporation.

- The excise tax does not apply to the extent that the repurchase is treated as a dividend for U.S. income tax purposes.

The Act directs the Secretary of the Treasury to prescribe regulations and guidance in connection with the new excise tax on corporate stock repurchases, including on the extent to which the new excise tax will apply to special classes of stock and preferred stock.

If applicable, the new excise tax will increase the costs of conducting stock repurchases. Corporations should consult with their professional accounting and tax advisors before engaging in any corporate stock repurchases to determine the effect of this new excise tax provision.

Please contact any of our attorneys below if you have any questions regarding the information contained in this newsletter.

John J. Gorman	(202) 274-2001	jgorman@luselaw.com
Lawrence Spaccasi	(202) 274-2037	lspaccasi@luselaw.com
Kip Weissman	(202) 274-2029	kweissman@luselaw.com
Kent Krudys	(202) 274-2019	kkrudys@luselaw.com
Marc Levy	(202) 274-2009	mlevy@luselaw.com
Ned Quint	(202) 274-2007	nquint@luselaw.com
Beverly White	(202) 274-2005	bwhite@luselaw.com
Benjamin Azoff	(202) 274-2010	bazoff@luselaw.com
Michael Brown	(202) 274-2003	mbrown@luselaw.com
Scott Brown	(202) 274-2013	sbrown@luselaw.com
Victor Cangelosi	(202) 274-2028	vcangelosi@luselaw.com
Jeffrey Cardone	(202) 274-2033	jcardone@luselaw.com
Thomas Hutton	(202) 274-2027	thutton@luselaw.com
Steven Lanter	(202) 274-2004	slanter@luselaw.com
Gary Lax	(202) 274-2031	glax@luselaw.com
Max Seltzer	(202) 274-2038	mseltzler@luselaw.com
Gregory Sobczak	(202) 274-2026	gsobczak@luselaw.com
Agata Troy	(202) 274-2025	atroy@luselaw.com

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