



Vinson & Elkins

Inflation Reduction Act of 2022: Excise Tax on Repurchases of Corporate Stock and Interesting Applications to SPACs

On August 16, 2022, the Inflation Reduction Act of 2022 (the “**IRA**”) was enacted into law. Among other changes to the Internal Revenue Code of 1986, as amended (the “**Code**”), the IRA imposes an excise tax on certain repurchases of corporate stock by certain publicly traded corporations (the “**Stock Buyback Tax**”).¹ The Stock Buyback Tax was a last-minute addition to the IRA to replace revenue lost by the elimination of the previously-proposed changes to the carried interest rules. It is intended to penalize corporations for engaging in what has become a common means of returning capital to shareholders. The following discussion is a high-level summary of the Stock Buyback Tax and certain potential implications thereof for corporate taxpayers. While the Stock Buyback Tax is applicable to all *covered corporations* (defined below), its application is particularly relevant to certain transactions involving special purpose acquisition companies (“**SPACs**”).

The Stock Buyback Tax is only one of the significant changes to the Code resulting from the enactment of the IRA. We also published a [summary of the renewable energy tax credit provisions](#) and the [environmental provisions \(including the methane emissions charge\)](#) of the IRA. Stay tuned for additional analysis and insight with respect to the IRA.

General

- **1% Excise Tax:** The Stock Buyback Tax imposes a 1% excise tax on *covered corporations* on the fair market value of any stock of the corporation which is *repurchased* by such corporation during any taxable year beginning after December 31, 2022.

Observations: As the Stock Buyback Tax is not effective until the 2023 taxable year, certain taxpayers may consider accelerating the execution of applicable repurchase transactions into the 2022 taxable year to the extent possible. It is generally not expected that the imposition of the Stock Buyback Tax will materially reduce the volume of stock buyback transactions—rather, the tax will primarily be viewed as an additional cost of execution. While not specified in the text of the legislation, it appears that the Stock Buyback Tax would be paid with a corporation’s U.S. federal income tax return for the taxable year in which the repurchase occurs.

- **Covered Corporations:** Covered corporations include any domestic corporation (and certain surrogate foreign corporations (*e.g.*, foreign corporations that have undergone transactions that satisfy either the 60% or 80% inversion tests under section 7874)) whose stock is traded on an *established securities market*.

Observations: As the Stock Buyback Tax applies to redemptions of all stock of covered corporations, the tax is even applicable to redemptions of non-publicly traded classes of stock. Redemptions effectuated by entities not treated as corporations for U.S. federal income tax purposes (*e.g.*, master limited partnerships) and foreign publicly traded corporations (other than surrogate foreign corporations) are not subject to the Stock Buyback Tax.

¹ Unless otherwise noted, references to “§” or “section” are to the Code or the Treasury Regulations promulgated thereunder.

Repurchased Stock

- **Repurchased Stock:** For purposes of the Stock Buyback Tax, a repurchase is any redemption of stock within the meaning of section 317(b). A repurchase also includes any transaction determined by the Secretary to be economically similar to a redemption of stock within the meaning of section 317(b). Under section 317(b), stock is treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, regardless of whether the reacquired stock is cancelled, retired, or held as treasury stock.
- **Adjustments:** The amount of repurchases in a taxable year subject to the Stock Buyback Tax is reduced by the fair market value of any stock issued by the covered corporation during such taxable year, including the fair market value of any stock issued or provided to employees of the covered corporation or specified affiliates.

Observations (General): Traditional stock buyback programs of publicly traded domestic corporations clearly fall within the scope of the Stock Buyback Tax. Additionally, stock redemptions occurring as part of reorganizations are also within the scope of the Stock Buyback Tax to the extent the reorganization exception (described below) is not applicable. Further, while a repurchase for purposes of the Stock Buyback Tax is defined by reference to existing section 317(b), there are open questions as to what constitutes a repurchase for these purposes. Accordingly, it will be important to analyze the application of the Stock Buyback Tax in M&A transactions that include the payment of non-stock consideration to shareholders of public targets.

Observations (SPACs): The Stock Buyback Tax is also applicable to certain SPAC redemptions, including in connection with a SPAC's business combination (or "**de-SPAC transaction**"). As noted above, the Stock Buyback Tax only applies to redemptions by domestic corporations occurring in taxable years beginning after December 31, 2022. Accordingly, for a calendar year domestic SPAC that may undertake redemptions in connection with an extension or amendment vote or at its outside date (i.e., the date by which the SPAC is required to either consummate a de-SPAC transaction or liquidate), such redemptions will not be subject to the Stock Buyback Tax to the extent they occur prior to December 31, 2022.

Redemptions occurring in connection with a de-SPAC transaction may be subject to the Stock Buyback Tax. As noted above, the amount of a redemption subject to the Stock Buyback Tax is reduced by the fair market value of any stock issued by the SPAC during the taxable year of the redemption. Accordingly, depending on the structure of a de-SPAC transaction, the impact of the Stock Buyback Tax may be reduced or eliminated by PIPE issuances, issuances pursuant to warrant exercises, the issuance of stock to target shareholders, founders, or sponsors in the de-SPAC transaction, the issuance of stock to employees under a long-term incentive plan, and any other stock issuances by the SPAC during the taxable year that includes the de-SPAC transaction.

To the extent an Up-C de-SPAC structure is utilized or the SPAC is the "target" in the de-SPAC transaction (including "double-dummy" transactions), the ability to mitigate the Stock Buyback Tax may be more limited as the SPAC likely will not issue material amounts of equity

consideration in such transaction structures. Cayman SPACs looking to domesticate in connection with a de-SPAC transaction should also analyze the potential impact of the Stock Buyback Tax with respect to redemptions occurring in connection with the domestication.

Whether distributions in complete liquidation of a domestic corporation are subject to the Stock Buyback Tax was not expressly addressed in the IRA and has not yet been addressed by the U.S. Treasury Department in regulations or other guidance. Consequently, for a domestic SPAC that reaches its outside date, whether the redemptions occurring in connection with the outside date are subject to the Stock Buyback Tax may depend on whether the SPAC is liquidated and, if so, whether the redemptions are structured as liquidating distributions that are not considered repurchases for these purposes. Even if the Stock Buyback Tax does apply, the redemption payments should be able to be reduced by the amount of the Stock Buyback Tax, since SPAC charters typically condition such payments on the amount of “lawfully available funds” and include express references to the Delaware General Corporation Law requirement to provide for the payment of creditors (which the Internal Revenue Service would be) and other provisions of applicable law.

Deemed Repurchases

- **Repurchases by Specified Affiliates:** If a *specified affiliate* of a covered corporation acquires stock of the covered corporation, the acquisition of stock will be treated as a repurchase of stock by the covered corporation. A *specified affiliate* is (i) any corporation in which 50% of the stock (by vote or by value) is owned, directly or indirectly, by the covered corporation, and (ii) any partnership in which 50% of the capital interests or profits interests is held, directly or indirectly, by the covered corporation.

Observations: As a result of these specified affiliate rules, the use of majority-owned or controlled subsidiaries to effect stock repurchases generally will not mitigate the impact of the Stock Buyback Tax.

Exceptions to the Stock Buyback Tax

- **Exceptions:** A number of exceptions to the Stock Buyback Tax are available, including (i) the repurchase of stock as part of a reorganization (within the meaning of section 368(a)) in which no gain or loss is recognized on such repurchase by a shareholder, (ii) the contribution of repurchased stock, or an amount of stock equal to the stock repurchased, to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan; (iii) the repurchase of stock during the taxable year that does not exceed \$1 million in total value, (iv) the repurchase of stock by a dealer in securities in the ordinary course of business, (v) the repurchase of stock by a regulated investment company or a real estate investment trust, and (vi) the repurchase of stock that is treated as a dividend.

Observations: While these exceptions may be helpful in limiting the application of the Stock Buyback Tax in situations in which it was not intended to apply, more guidance will be necessary for taxpayers to analyze the potential application of these exceptions and whether they will be able to rely upon them.