U.S. Chamber of Commerce

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June 11, 2024

Dr. Aviva Aron-Dine
Acting Assistant Secretary (Tax Policy)
U.S. Department of Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220

The Honorable Marjorie A. Rollinson
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue N.W.
Washington, D.C. 20224

Re: Excise Tax on Repurchase of Corporate Stock (REG-115710-22)

Dear Dr. Aron-Dine and Ms. Rollinson:

The U.S. Chamber of Commerce ("Chamber") welcomes the opportunity to comment on the proposed regulations under section 4501 of the Internal Revenue Code,[1] which would provide guidance regarding the application of the new excise tax on repurchases of corporate stock made after December 31, 2022.[2] Section 4501 was enacted as part of the Inflation Reduction Act of 2022 ("IRA"),[3] and would affect certain publicly traded corporations that repurchase their stock or whose stock is acquired by certain specified affiliates.

The Chamber commends the Department of Treasury ("Treasury") and the Internal Revenue Service ("IRS") for their efforts to provide taxpayers with a reasonably comprehensive package of proposed guidance regarding the substantive application of the new excise tax. At the same time, however, the Chamber is concerned that the proposed regulations would inappropriately expand the levy's application to certain instruments and transactions not envisioned by Congress. The following comments focus on two particularly problematic aspects of the proposed regulations and provide reasoned, consensus-based recommendations for addressing them in a manner consistent with the underlying statute and congressional intent.

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[1] Unless otherwise indicated, all textual references to "section" herein are to sections of the Internal Revenue Code of 1986, as amended ("Code").

[2] Excise Tax on Repurchase of Corporate Stock, 89 Fed. Reg. 25980 (proposed April 12, 2024) (to be codified at 26 C.F.R. pt. 58).

[3] An Act to provide for reconciliation pursuant to title II of S. Con. Res. 14, Pub. L. No. 117-169, § 10201, 136 Stat. 1818, 1828–31 (2022).

Background

The stock repurchase excise tax was introduced as both a new source of revenue and a means to encourage corporations to reinvest in their businesses and employees rather than repurchase shares.[4] Proponents of the measure also sought to address perceived tax avoidance at the shareholder level by the use of a corporation's earnings to reacquire its stock rather than make dividend distributions.[5]

Section 4501 generally imposes a non-deductible 1% excise tax on the fair market value of stock redeemed by a publicly traded U.S. corporation during the taxable year, less the fair market value of stock issued by the corporation during that year.[6] As written, the tax generally applies to the repurchase of "any stock of the corporation," regardless of whether the stock redeemed was of a class that is traded on an established securities market. Recognizing the levy's potential application to transactions where no opportunity for tax avoidance—real or perceived—exists, however, Congress enumerated six exceptions to this general rule.[7] It also directed Treasury to prescribe such regulations and other guidance as are necessary or appropriate "to address special classes of stock and preferred stock."[8] Save for one exceedingly narrow exception, however, the proposed regulations would fail to heed this congressional command.

Proposed Application to Preferred Stock

The proposed regulations would define the term "stock" broadly to mean any instrument issued by a corporation that is stock or treated as stock for federal tax purposes at the time of issuance, regardless of whether the instrument is traded on an established securities market.[9] The sole, limited exception to this expansive definition would be for "additional tier 1 capital," which is a type of preferred stock

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[4] *See, e.g.*, 167 Cong. Rec. S6451 (daily ed. Sept. 13, 2021) (statement of Sen. Sherrod Brown introducing S. 2758, the Stock Buyback Accountability Act of 2021, the predecessor to section 4501, citing the perception that companies implement stock repurchase programs to opportunistically drive up their stock price, enrich wealthy shareholders and corporate insiders, and increase the value of executives' compensation packages).

[5] *See id*.

[6] I.R.C. § 4501(a), (c)(3).

[7] *See* I.R.C. § 4501(e)(1)–(6).

[8] I.R.C. § 4501(f)(2).

[9] Prop. Treas. Reg. § 58.4501-1(b)(29).

meeting specific criteria related to bank regulatory capital qualifications.[10] Thus, unless this limited-scope exception for additional tier 1 preferred capital applies, the stock repurchase excise tax would apply to preferred stock in the same manner as to common stock. Such a blanket, reflexive application to preferred stock would contravene congressional intent and warrants reconsideration—especially with respect to plain vanilla and mandatorily redeemable preferred stock, as discussed below.

Plain Vanilla Preferred Stock

When Congress enacted the stock repurchase excise tax in section 4501, lawmakers explicitly recognized that preferred stock may warrant special treatment and directed Treasury to prescribe regulations or other guidance to address it. The significance of this statutory admonition becomes clear upon considering the characteristics of preferred stock that distinguish it from common stock.

For federal tax purposes, the term "preferred stock" generally refers to stock that, in relation to other classes of stock outstanding, enjoys certain limited rights and privileges (generally associated with specified dividend and liquidation priorities) but does not participate in corporate growth to any significant extent.[11] By contrast, quintessentially common stock provides for an equal pro rata share of the profits and assets of the corporation with no preference or advantage over other stock. Redemptions of preferred stock differ from typical stock buybacks in that preferred stock functions more like a fixed income-type instrument than common stock and is often redeemable—either voluntarily or mandatorily—by the issuer at a specified price on or after a specified date. The lower volatility of preferred stock makes it a more attractive investment to tax-exempt and institutional investors, which are usually the most common holders of preferred stock.

This dichotomy is most acute in the case of straight or "plain vanilla" preferred stock. Corporate stock with the following four characteristics is considered plain vanilla preferred stock for federal tax purposes: (1) nonvoting; (2) limited and preferred as to dividends and without participation in corporate growth to any significant extent; (3) limited redemption and liquidation premium rights; and (4) nonconvertible.[12] With such characteristics, redemptions of plain vanilla preferred stock are

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[10] *See* Prop. Tres. Reg. § 58.4501-1(b)(29)(ii).

[11] *See, e.g.*, Treas. Reg. § 1.305-5(a).

[12] *See generally* I.R.C. §§ 382(k)(6)(A), 1504(a)(4).

qualitatively akin to repaying a class of debt and bear no resemblance to the type of opportunistic stock repurchases that Congress sought to curtail with the new stock repurchase excise tax.

Mandatorily Redeemable Stock

As discussed above, a corporation's decision to repurchase preferred stock is qualitatively different from the decision to repurchase common stock. In some cases, however, it isn't a decision at all: the corporation may be required to repurchase stock pursuant to a mandatory redemption provision (e.g., a maturity date on which the company must repurchase the stock) or a unilateral put option of the shareholder.[13] Applying the new excise tax to the redemption of such stock would be inappropriate because the redemption is neither within the control of nor susceptible to any timing manipulation by the issuing corporation.[14] By definition, such redemptions are the antithesis of the opportunistic stock repurchases that Congress sought to curtail in enacting section 4501 and should therefore be excluded from its application.

The preceding paragraphs illustrate how the proposed regulations would require inappropriate applications of the stock repurchase excise tax beyond its intended purpose while imposing retroactive tax increases on issuing corporations. They would also effectively impose a new tax on the ability of companies to raise capital without issuing debt or diluting the interests of existing shareholders—including many retirees, tax-exempts, and institutional investors—making it harder for companies to finance capital-intensive projects that drive job creation. It is clear from the debate around the new excise tax that these outcomes would contravene congressional intent and therefore, warrant a different approach in final regulations. The Chamber respectfully urges Treasury and the IRS to reconsider their proposed application of the stock repurchase excise tax to redemptions of preferred stock—especially plain vanilla and mandatorily redeemable preferred stock, as set forth above.

The Proposed Funding Rule

In enacting the new stock repurchase excise tax, Congress provided special rules for its application to acquisitions of stock of certain foreign corporations. One

[13] Mandatorily redeemable shares are often issued to employees by their employer as a form of compensation.

[14] The impropriety of applying the stock repurchase excise tax to redemptions of such stock would be especially egregious in cases where the stock was issued prior to the date of the IRA's enactment.

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of these rules appears in section 4501(d)(1), which applies "[i]n the case of an acquisition of stock of an applicable foreign corporation by a specified affiliate of such corporation." Under this rule, the acquisition of a foreign publicly traded corporation's stock by a U.S. specified affiliate of the corporation will be treated as a repurchase subject to the stock repurchase excise tax.[15]

While the statute by its terms applies only to acquisitions of an applicable foreign corporation's stock by a U.S. specified affiliate of that corporation, the proposed regulations would expand the application of the stock repurchase excise tax to repurchases made by the foreign corporation itself. Under the proposed "funding rule," a U.S. specified affiliate of an applicable foreign corporation would be treated as acquiring stock of the applicable foreign corporation to the extent the U.S. affiliate "funds by any means (including through distributions, debt, or capital contributions), directly or indirectly, a covered purchase with a principal purpose of avoiding the section 4501(d) excise tax."[16] Here, the Chamber shares the view expressed by numerous other stakeholders that the proposed funding rule is not supported by the text of the statute and would contravene congressional intent.[17] Treasury and the IRS should withdraw the proposed funding rule and omit it from the final regulations.

Application to Ordinary Course Transactions

Should Treasury and the IRS ultimately decide to retain the proposed funding rule in the final regulations, the Chamber would respectfully urge Treasury and the IRS to expressly preclude its application to ordinary course transactions. Treasury's own press release characterizes the proposed funding rule as "a targeted anti-abuse rule" to ensure compliance by foreign-parented multinational corporations "without ordinary course intercompany funding transactions among their corporate affiliates

[15] Where a U.S. specified affiliate of an applicable foreign corporation acquires stock of the applicable foreign corporation, section 4501(d)(1) treats the acquisition as a repurchase of the U.S. affiliate's stock.

[16] Prop. Treas. Reg. § 58.4501–7(e)(1).

[17] *See, e.g.*, N.Y. St. B. Ass'n Tax Sec., Rep. No. 1494, Report on Proposed Regulations Under Section 4501 8 (June 4, 2024) (observing, inter alia, that the statute makes no reference to an acquisition that is "funded" or made "directly or indirectly" by a specified affiliate, and that Congress obviously could have included such language or written a broader rule if it intended the excise tax to apply to a broader range of transactions involving foreign public companies).

being inadvertently captured."[18] As described below, however, the proposed funding rule would do just that to typical cross-border cash pooling arrangements.

A covered "funding" for purposes of the proposed funding rule is extremely broad and would include the transfer of funds "by any means."[19] A covered funding would therefore include payments made by a U.S. subsidiary to its foreign parent, including cash sweeps under a cross-border cash pooling arrangement. Cash pooling is a generally accepted and often necessary treasury management tool that allows multinational corporate groups to maximize the use of internal funds through centralizing such funds at one designated entity (cash pool entity). Generally, each company in the cash pooling arrangement will have their cash "swept" on a regular basis (e.g., every night), which usually takes the form of a loan from the operating entities that generate the cash to a holding company that acts as the cash pool entity. Under the proposed funding rule, however, if the cash pool entity is a foreign corporation, a daily cash sweep from any U.S. subsidiary cold be considered a covered funding. This is alarming because every foreign parented multinational group with U.S. subsidiaries and a cash pool entity that operates a typical cash pooling arrangement would be subjected to the new stock repurchase excise tax.

Furthermore, it is unclear how a taxpayer would establish that transfers of funds from the U.S. affiliates did not have a "principal purpose of avoiding the section 4501(d) excise tax" in a cross-border cash pooling arrangement. Treasury and the IRS explain in their preamble to the proposed regulations that they did not adopt a tracing mechanism to determine which funding sources were used for which purposes. In a typical cross-border cash pooling arrangement, where the daily cash sweep is from U.S. entities as well as foreign entities, it would be impracticable to trace which funds were used for a "repurchase."

In view of the above, the Chamber would respectfully urge Treasury and the IRS to issue final regulations clarifying that the funding rule will not apply to cross-border cash pooling arrangements. By the same logic, Treasury and the IRS should also make clear that the funding rule will not apply to other ordinary course intercompany transactions like distributions, royalties, or service payments from a U.S. subsidiary corporation to its foreign parent. And further clarification of what constitutes a "principal purpose" for purposes of the funding rule would also be required.

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[18] U.S. Dep't of the Treas, Press Release, *U.S. Department of the Treasury and IRS Release Proposed Guidance on Stock Buyback Excise Tax to Ensure Large Corporations Pay More of Their Fair Share in Taxes* (Apr. 9, 2024), https://home.treasury.gov/news/press-releases/jy2244.

[19] Prop. Treas. Reg. § 58.4501–7(e)(1).

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The Chamber appreciates the opportunity to comment on the proposed regulations, and we urge Treasury and the IRS to engage closely with the business community throughout the IRA implementation process. In the interim, we would welcome the opportunity to discuss our comments with you or your colleagues in further detail and provide whatever additional information you may require. Please contact Sarah Corrigan, the Chamber's Tax Counsel, at (202) 680-8008 or SCorrigan@USChamber.com. Thank you for your time and attention.

Sincerely,

W.M. McLeish

Watson M. McLeish
Senior Vice President, Tax Policy
U.S. Chamber of Commerce

cc: The Honorable Ronald L. Wyden, Chairman, Committee on Finance, United States Senate
The Honorable Michael D. Crapo, Ranking Member, Committee on Finance, United States Senate
The Honorable Jason T. Smith, Chairman, Committee on Ways and Means, United States House of Representatives
The Honorable Richard E. Neal, Ranking Member, Committee on Ways and Means, United States House of Representatives
Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation, United States Congress