DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 58

[REG–115710–22]

RIN 1545–BQ59

Excise Tax on Repurchase of Corporate Stock

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would provide guidance regarding the application of the new excise tax on repurchases of corporate stock made after December 31, 2022. The proposed regulations would affect certain publicly traded corporations that repurchase their stock or whose stock is acquired by certain specified affiliates. Another notice of proposed rulemaking (REG–118499–23) on this topic is published in the Proposed Rules section of this issue of the **Federal Register** to propose rules on procedure and administration applicable to this new excise tax.

DATES: Written or electronic comments and requests for a public hearing must be received by June 11, 2024.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG–115710–22) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the ''Comments and Requests for a Public Hearing'' section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket.

Send paper submissions to: CC:PA:01:PR (REG–115710–22), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning proposed §§ 58.4501–1 through 58.4501–6, Samuel G. Trammell at (202) 317–6975; concerning proposed § 58.4501–7, Brittany N. Dobi at (202) 317–5469; concerning proposed § 1.1275–6(f)(12)(iii), Jonathan A. LaPlante at (202) 317–3900; concerning submissions of comments and requests for a public hearing, Vivian Hayes at (202) 317–6901 (not toll-free numbers) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Background

This notice of proposed rulemaking proposes regulations under section 4501 of the Internal Revenue Code (Code) that would implement the new excise tax on repurchases of corporate stock (stock repurchase excise tax) imposed by section 4501 for repurchases made after December 31, 2022. As proposed in this notice of proposed rulemaking, the regulations are proposed to be added as proposed subpart A of new 26 CFR part 58 (Stock Repurchase Excise Tax Regulations), which is proposed to be added to subchapter D of 26 CFR chapter I (Miscellaneous Excise Taxes). This notice of proposed rulemaking also proposes to amend regulations under section 1275 of the Code in 26 CFR part 1 (Income Tax Regulations) to implement the provisions of section 4501. Another notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register** relating to the stock repurchase excise tax proposes rules on procedure and administration applicable to the reporting and payment of the stock repurchase excise tax that would be added as proposed subpart B of 26 CFR part 58.

I. Overview of Section 4501

A. In General

Section 4501 was added to a new chapter 37 of the Code by the enactment of section 10201 of Public Law 117–169, 136 Stat. 1818 (August 16, 2022), commonly referred to as the Inflation Reduction Act of 2022 (IRA). Section 4501 imposes the stock repurchase excise tax on each covered corporation for repurchases made after December 31, 2022. The stock repurchase excise tax is equal to one percent of the fair market value of any stock of the corporation that is repurchased by the corporation during the taxable year. Section 4501(a). For purposes of the stock repurchase excise tax, the term ''covered corporation'' means any domestic corporation the stock of which is traded on an established securities market (within the meaning of section 7704(b)(1) of the Code). Section 4501(b).

Section 4501(c)(1) provides that repurchases of covered corporation stock to which the stock repurchase excise tax may apply include the following two types of transactions. First, the term ''repurchase'' means a redemption within the meaning of section 317(b) of the Code with regard to the stock of a covered corporation (section 317(b) redemption). Section 4501(c)(1)(A). Second, the term ''repurchase'' also means any transaction determined by the Secretary of the Treasury or her delegate (Secretary) to be economically similar to a section 317(b) redemption (economically similar transaction). Section 4501(c)(1)(B).

B. Specified Affiliates

For purposes of the stock repurchase excise tax, section 4501(c)(2)(A) provides a special rule that treats the acquisition of stock of a covered corporation by a specified affiliate of the covered corporation, from a person who is not the covered corporation or a specified affiliate of the covered corporation, as a repurchase of the stock of the covered corporation by the covered corporation. For this purpose, the term ''specified affiliate'' means, with regard to any corporation, (i) any corporation more than 50 percent of the stock of which is owned (by vote or by value), directly or indirectly, by the corporation, and (ii) any partnership more than 50 percent of the capital interests or profits interests of which is held, directly or indirectly, by the corporation. Section 4501(c)(2)(B).

C. Adjustment to Amount Taken Into Account Under Section 4501(a)

The stock repurchase excise tax is applied to the fair market value of any stock of the covered corporation repurchased by the covered corporation during its taxable year. However, the amount of these repurchases is reduced by the fair market value of any issuances of the covered corporation's stock during the covered corporation's taxable year (netting rule).

Specifically, the netting rule provides that the amount taken into account under section 4501(a) with respect to any stock repurchased by a covered corporation is reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including the fair market value of any stock issued or provided to employees of the covered corporation or employees of a specified affiliate of the covered corporation during the taxable year (whether or not the stock is issued or provided in response to the exercise of an option to purchase the stock). Section 4501(c)(3).

D. Special Rules for Certain Acquisitions and Repurchases of Stock of Certain Foreign Corporations

Section 4501(d) provides special rules for the imposition of the stock repurchase excise tax on acquisitions of

stock of applicable foreign corporations and covered surrogate foreign corporations. For purposes of section 4501(d), the term ''applicable foreign corporation'' means any foreign corporation the stock of which is traded on an established securities market. Section 4501(d)(3)(A). The term ''covered surrogate foreign corporation'' means any surrogate foreign corporation (as determined under section 7874(a)(2)(B) of the Code by substituting ''September 20, 2021'' for ''March 4, 2003'' each place it appears) the stock of which is traded on an established securities market, but only with respect to taxable years that include any portion of the applicable period with respect to that corporation under section 7874(d)(1). Section 4501(d)(3)(B).

Section 4501(d)(1) applies in the case of an acquisition of stock of an applicable foreign corporation by a specified affiliate of the corporation (other than a foreign corporation or a foreign partnership (unless the partnership has a domestic entity as a direct or indirect partner)) from a person that is not the applicable foreign corporation or a specified affiliate of the applicable foreign corporation. If section 4501(d)(1) applies, then for purposes of determining the stock repurchase excise tax: (i) the specified affiliate is treated as a covered corporation with respect to the acquisition; (ii) the acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation; and (iii) the adjustment under section 4501(c)(3) (that is, the netting rule) is determined only with respect to stock issued or provided by the specified affiliate to employees of the specified affiliate.

Section 4501(d)(2) applies in the case of either a repurchase of stock of a covered surrogate foreign corporation by the covered surrogate foreign corporation, or an acquisition of stock of a covered surrogate foreign corporation by a specified affiliate of such corporation. If section 4501(d)(2) applies, then for purposes of determining the stock repurchase excise tax: (i) the expatriated entity (within the meaning of section 7874(a)(2)(A)) with respect to the covered surrogate foreign corporation is treated as a covered corporation with respect to the repurchase or acquisition; (ii) the repurchase or acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation; and (iii) the adjustment under section 4501(c)(3) is determined only with respect to stock issued or provided by the expatriated entity to employees of the expatriated entity.

E. Statutory Exceptions to the Application of Section 4501(a)

Section 4501(e) lists transactions that are statutorily excepted, in whole or in part, from the application of section 4501(a), each referred to as a ''statutory exception'' in this preamble. As a result of the statutory exceptions, section 4501(a) does not apply to a repurchase of a covered corporation's stock:

(1) To the extent that the repurchase is part of a reorganization (within the meaning of section 368(a) of the Code) and no gain or loss is recognized on the repurchase by the shareholder under chapter 1 of the Code (chapter 1) by reason of the reorganization (section 4501(e)(1));

(2) In any case in which the stock repurchased is, 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 (section 4501(e)(2));

(3) In any case in which the total value of the stock repurchased during the taxable year does not exceed $1,000,000 (section 4501(e)(3));

(4) Under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business (section 4501(e)(4));

(5) By a regulated investment company (RIC), as defined in section 851 of the Code, or by a real estate investment trust (REIT), as defined in section 856(a) of the Code (section 4501(e)(5)); or

(6) To the extent that the repurchase is treated as a dividend for purposes of the Code (section 4501(e)(6)).

F. Regulations and Other Guidance

Under section 4501(f), the Secretary is authorized to prescribe such regulations and other guidance as are necessary or appropriate to carry out, and to prevent the avoidance of, the purposes of the stock repurchase excise tax. Regulations or other guidance described in section 4501(f) may include guidance: (i) to prevent the abuse of the statutory exceptions; (ii) to address special classes of stock and preferred stock; and (iii) for the application of the special rules for acquisitions of stock of certain foreign corporations under section 4501(d).

G. Applicability of Stock Repurchase Excise Tax Provisions

Except to the extent that a statutory exception applies, the stock repurchase excise tax applies to repurchases after December 31, 2022, subject to the netting rule. *See* section 10201(d) of the IRA.

In contrast to the December 31, 2022, effective date expressly provided by section 10201(d) of the IRA with regard to repurchases, the netting rule expressly takes into account any issuances by a covered corporation during the entirety of its taxable year. *See generally* section 4501(c)(3). Specifically, under the netting rule, the amount taken into account under section 4501(a) with respect to any repurchases is ''reduced by the fair market value of *any stock issued by the covered corporation during the taxable year.* ''Section 4501(c)(3) (*emphasis added*). Therefore, a covered corporation with a taxable year that both began before January 1, 2023, and ended after December 31, 2022, may apply the netting rule to reduce the fair market value of the covered corporation's repurchases of stock during the portion of that taxable year beginning on January 1, 2023, by the fair market value of all issuances of its stock during the entirety of that taxable year.

H. No Deduction for Payment of Stock Repurchase Excise Tax

No deduction is allowed for the payment of the stock repurchase excise tax. *See* section 275(a)(6) of the Code (as amended by section 10201(b) of the IRA to add a reference to chapter 37, which contains section 4501).

II. Notice 2023–2

On January 17, 2023, the Treasury Department and the IRS published Notice 2023–2, 2023–3 I.R.B. 374, to provide initial guidance regarding the application of the stock repurchase excise tax. Specifically, the Treasury Department and the IRS published Notice 2023–2 to facilitate administration of the stock repurchase excise tax by describing rules expected to be provided in forthcoming proposed regulations for determining the amount of stock repurchase excise tax owed, along with anticipated rules for reporting and paying any liability for the tax.

Under those rules, the amount of stock repurchase excise tax imposed on a covered corporation equals the product obtained by multiplying one percent by the stock repurchase excise tax base of the covered corporation. The ''stock repurchase excise tax base'' is the amount (not less than zero) obtained by: (i) determining the aggregate fair market value of all repurchases of the covered corporation's stock by the covered corporation during its taxable year; (ii) reducing that amount by the fair market value of stock of the covered corporation repurchased during its taxable year to the extent any statutory

exceptions apply; and then (iii) further reducing that amount by the aggregate fair market value of stock of the covered corporation issued or provided by the covered corporation during its taxable year under the netting rule.

The Treasury Department and the IRS have received feedback on the stock repurchase excise tax, including in response to Notice 2023–2. Based on the feedback received, and based on further consideration of section 4501 and Notice 2023–2, the Treasury Department and the IRS are proposing these regulations under section 4501 to be added as a new part 58 under the Miscellaneous Excise Taxes, as well as adding new § 1.1275–6(f)(12)(iii) to 26 CFR part 1.

The issues related to section 4501 and Notice 2023–2 with respect to which stakeholders have provided feedback, as well as issues that the Treasury Department and the IRS have considered after the publication of Notice 2023–2, are discussed in the following Explanation of Provisions.

Explanation of Provisions

Subpart A of new part 58 would provide operative rules under section 4501. Proposed § 58.4501–1 would provide an overview of the stock repurchase excise tax, generally applicable definitions, the scope of the regulations implementing that tax, and certain operating rules applicable to those regulations. Proposed § 58.4501–2 would provide general rules regarding the application and computation of the stock repurchase excise tax and proposed § 58.4501–7 would provide rules specifically relating to the application of section 4501(d). Except as provided in proposed § 58.4501–7, proposed § 58.4501–3 would provide rules regarding the application of the exceptions in section 4501(e) (other than the de minimis exception described in section 4501(e)(3) and to which proposed § 58.4501–2(b)(2) applies), and proposed § 58.4501–4 would provide rules regarding the application of section 4501(c)(3). Proposed § 58.4501–5 would provide examples that illustrate the application of section 4501, other than the provisions of proposed § 58.4501–7 (which are illustrated by examples in § 58.4501–7(p) and (q)), and proposed § 58.4501–6 would provide applicability dates (other than for the rules in § 58.4501–7).

I. Statutory Effective Date; Transition Relief

A. Repurchases by a Fiscal-Year Taxpayer Prior to the Statutory Effective Date

A covered corporation is not subject to the stock repurchase excise tax with regard to a taxable year if, during that taxable year, the aggregate fair market value of the covered corporation's repurchases of its stock does not exceed $1,000,000 (de minimis exception). *See* section 4501(e)(3); *see also* section 3.03(2)(a) of Notice 2023–2.

One stakeholder requested that the proposed regulations make clear that repurchases of stock by a fiscal-year taxpayer prior to the January 1, 2023, effective date of section 4501 are not taken into account for purposes of applying the de minimis exception. According to the stakeholder, the plain language of the statute requires that repurchases by a fiscal-year taxpayer prior to January 1, 2023, not be taken into account for any purpose under section 4501, including for purposes of applying the de minimis exception.

The Treasury Department and the IRS have interpreted section 4501 in the same manner. The rule described in section 3.03(3)(b) of Notice 2023–2 provides that repurchases by a covered corporation before January 1, 2023, are not included in the covered corporation's stock repurchase excise tax base. The proposed regulations would clarify that repurchases before January 1, 2023, are not taken into account for purposes of applying the de minimis exception. *See* proposed § 58.4501–2(c)(3).

B. Issuances by a Fiscal-Year Taxpayer Prior to the Effective Date

One stakeholder recommended that stock issued by a fiscal-year taxpayer prior to January 1, 2023, should not be taken into account for purposes of the netting rule, because such an approach would create a mismatch between the treatment of issuances for purposes of the netting rule and the treatment of repurchases for purposes of the de minimis exception. *See* part I.A of this Explanation of Provisions. Another stakeholder recommended that fiscal-year taxpayers be permitted to use only net issuances (that is, issuances net of repurchases) from the portion of their taxable year prior to January 1, 2023, because, according to the stakeholder, taxpayers arguably should not be permitted to offset gross issuances during the portion of a fiscal year before January 1, 2023, against repurchases during the portion of a fiscal year beginning on January 1, 2023.

The Treasury Department and the IRS disagree with the stakeholders' recommendations. Section 4501(c)(3) expressly provides that the amount taken into account under section 4501(a) with respect to any stock repurchased by a covered corporation is reduced by the fair market value of any stock issued by the covered corporation ''during the taxable year.'' Moreover, although section 10201(d) of the IRA expressly provides that the stock repurchase excise tax applies to *repurchases* after December 31, 2022, it does not contain similar language for *issuances.* Therefore, the Treasury Department and the IRS are of the view that, in the case of a covered corporation that has a taxable year that both begins before January 1, 2023, and ends after December 31, 2022, that covered corporation may apply the netting rule to reduce the fair market value of the covered corporation's repurchases during that taxable year by the fair market value of all issuances of its stock during the entirety of that taxable year. *See* proposed § 58.4501–4(b)(3). Thus, the proposed regulations would not adopt these recommendations.

C. Contributions by Fiscal-Year Taxpayer to Employer-Sponsored Retirement Plan Prior to Effective Date

A stakeholder also recommended that stock contributed by a fiscal-year taxpayer to an employer-sponsored retirement plan prior to the January 1, 2023, effective date of section 4501, should not be taken into account for purposes of the statutory exception in section 4501(e)(2) because, according to the stakeholder, such an approach would create a mismatch between this exception and the de minimis exception. However, as discussed in part I.B of this Explanation of Provisions, the effective date in section 10201(d) of the IRA expressly applies to repurchases (and not to issuances or contributions). Therefore, the Treasury Department and the IRS are of the view that contributions to an employer-sponsored retirement plan during the 2022 portion of a taxable year beginning before January 1, 2023, and ending after December 31, 2022, should be taken into account for purposes of section 4501(e)(2). *See* proposed § 58.4501–3(d)(5).

D. Trade Date or Settlement Date

A stakeholder asked whether the date of repurchase of stock occurs on (i) the trade date for the sale or purchase of that stock (that is, the date a broker executes the trade), or (ii) the settlement date with regard to that stock (that is, the date the shares are delivered). The

stakeholder asked this question for purposes of determining whether a repurchase occurs after the effective date of section 4501. The stakeholder requested that the proposed regulations clarify that the trade date for the sale or purchase of that stock constitutes the date of repurchase.

The proposed regulations would clarify that the date of repurchase for a regular-way sale of stock on an established securities market (that is, a transaction in which a trade order is placed on the trade date, and settlement of the transaction, including payment and delivery of the stock, occurs a standardized number of days after the trade date) is the trade date. *See* proposed § 58.4501–2(g)(2). For rules regarding the date of repurchase generally, *see* part III.B.1 of this Explanation of Provisions.

E. Transition Relief for Certain Transactions Entered Into Prior to Enactment Date

Several stakeholders requested transition relief (that is, an exemption from the stock repurchase excise tax) for certain repurchases that occur after the January 1, 2023, effective date of section 4501, pursuant to a binding commitment entered into before the August 16, 2022, enactment date of section 4501. For example, one stakeholder requested an exemption for redemptions of stock issued before the enactment date and redeemed pursuant to the terms of the stock after the effective date, on the grounds that the stock repurchase excise tax did not exist when the terms of that stock were negotiated. Another stakeholder suggested that candidates for transition relief could include: (i) redemptions by, and liquidations of, a special purpose acquisition company (SPAC) formed prior to the enactment date (to the extent the SPAC is contractually obligated to offer redemption rights to its shareholders as agreed prior to the enactment date); (ii) payments in connection with merger and acquisition (M&A) transactions pursuant to a binding commitment entered into prior to the enactment date; (iii) redemptions of non-participating, non-convertible preferred stock, and complete redemptions of tracking stock, issued prior to the enactment date; (iv) repurchases pursuant to accelerated share repurchase agreements if completed pursuant to a binding commitment entered into prior to the enactment date; and (v) liquidating distributions subject to section 331 of the Code pursuant to a plan of liquidation adopted prior to the enactment date.

The plain language of section 10201(d) of the IRA provides that the amendments made by section 10201 of the IRA apply to repurchases of stock after December 31, 2022. That section contains no reference to repurchases that occur pursuant to a binding commitment entered into prior to the enactment date. As a result, the Treasury Department and the IRS are of the view that transition relief would not be appropriate. The proposed regulations accordingly would not adopt the stakeholders' recommendation.

II. Application of the Stock Repurchase Excise Tax to Various Types of Financial Instruments

A. Definition of ''Stock''

For purposes of Notice 2023–2, ''stock'' would be defined as any instrument issued by a corporation that is stock or that is treated as stock for Federal tax purposes at the time of issuance, regardless of whether the instrument is traded on an established securities market. *See* section 3.02(25) of Notice 2023–2.

The proposed regulations generally would maintain this definition of ''stock.'' *See* proposed § 58.4501–1(b)(29). However, the proposed definition of ''stock'' would not include ''additional tier 1 preferred stock,'' which the proposed regulations would define to mean preferred stock that qualifies as additional tier 1 capital (within the meaning of 12 CFR 3.20(c), 217.20(c), or 324.20(c)) and does not qualify as common equity tier 1 capital (within the meaning of 12 CFR 3.20(b), 217.20(b), or 324.20(b)). *See* proposed § 58.4501–1(b)(29)(ii). Therefore, unless the limited-scope exception regarding additional tier 1 preferred stock applies, the stock repurchase excise tax would apply to preferred stock in the same manner as to common stock. Likewise, the stock repurchase excise tax would apply to repurchases of instruments that are not in the legal form of stock but that are treated as stock for Federal tax purposes at the time of issuance. In contrast, the stock repurchase excise tax would not apply to repurchases of instruments treated as debt for Federal tax purposes.

The proposed regulations would include the foregoing definition of ''stock'' for the following reasons. First, the plain language of section 4501 repeatedly refers to ''stock'' and does not, for example, refer solely to ''common stock.'' *See,* for example, section 4501(a) (imposing an excise tax ''equal to 1 percent of the fair market value of any stock of the corporation''); section 4501(b) (defining the term covered corporation to mean ''any domestic corporation the stock of which is traded on an established securities market''); section 4501(c)(1)(A) (defining the term repurchase to mean a redemption within the meaning of section 317(b) ''with regard to the stock of a covered corporation''). Second, if the stock repurchase excise tax were implemented to be applicable solely to common stock, then taxpayers could avoid the tax simply by repurchasing other classes of stock (or other instruments treated as stock for Federal tax purposes).

Section 4501(f)(2) authorizes the Secretary to issue such regulations and other guidance as are necessary or appropriate to carry out, and to prevent the avoidance of, the purposes of the stock repurchase excise tax, including guidance ''to address special classes of stock and preferred stock.'' Accordingly, in section 6.01(1) of Notice 2023–2, the Treasury Department and the IRS requested comments on whether there are circumstances under which special rules should be provided for redeemable preferred stock or other special classes of stock or debt (including debt with features that allow the debt to be converted into stock) and, if so, what objectively verifiable criteria should be incorporated into such special rules to provide certainty for taxpayers and the IRS.

1. Straight Preferred Stock; Mandatorily Redeemable Stock

Stakeholders recommended that the stock repurchase excise tax should not apply to redemptions of preferred stock. Although two stakeholders recommended an exception for redemptions of any type of preferred stock, other stakeholders generally recommended an exception only for redemptions of so-called ''straight preferred stock'' (that is, preferred stock that is limited and preferred as to dividends, does not participate in corporate growth to any significant extent, and is not convertible into another class of stock). *See* section 1504(a)(4)(B) and (D) of the Code. One stakeholder also argued against providing an exception for redemptions of preferred stock other than straight preferred stock. *See* part II.A.2 of this Explanation of Provisions.

The stakeholders uniformly contended that, although straight preferred stock is treated as ''stock'' for Federal tax purposes, repayments of such stock are akin to repaying debt and do not implicate the policy concerns underlying the stock repurchase excise tax. The stakeholders further contended that, if redemptions of straight preferred

stock were subject to the stock repurchase excise tax, publicly traded corporations might be incentivized to increase their leverage by issuing debt in lieu of straight preferred stock.

One stakeholder also recommended a rule under which actual or deemed issuances of straight preferred stock would not be taken into account for purposes of the netting rule. The stakeholder further recommended that exchanges of straight preferred stock for other stock (that is, for stock to which the stock repurchase excise tax applies) should be treated as economically similar transactions.

Alternatively, stakeholders recommended an exception to the stock repurchase excise tax for the redemption of stock pursuant to a mandatory redemption provision or a unilateral put option of the shareholder. In the stakeholders' view, this exception would be appropriate because such a redemption would not be within the control of (and would not be susceptible to any timing manipulation by) the issuing corporation.

As described in part II.A of this Explanation of Provisions, the plain language of section 4501 consistently refers to ''stock'' without providing any exceptions for particular types of stock. In addition, the Treasury Department and the IRS are of the view that Treasury regulations that utilize the broadly applicable term ''stock'' would facilitate the IRS's ability to administer and enforce the stock repurchase excise tax. Consequently, the Treasury Department and the IRS also are of the view that adoption of the stakeholders' numerous suggested exceptions would significantly hamper the IRS's ability to administer and enforce that tax, as well as reduce taxpayer certainty regarding its application. Therefore, except with regard to additional tier 1 preferred stock, the proposed regulations would not incorporate the stakeholders' suggested exceptions. *See* proposed §§ 58.4501–1(b)(29), 58.4501–2(e)(2), and 58.4501–4(b)(1); *see also* proposed § 58.4501–1(b)(29)(ii) and part II.A.3 of this Explanation of Provisions (discussion of additional tier 1 preferred stock).

2. Convertible Preferred Stock and Participating Preferred Stock

One stakeholder recommended that, even if straight preferred stock is excluded from the stock repurchase excise tax, preferred stock that is convertible into the issuer's common stock at the holder's option (convertible preferred stock), and preferred stock with certain dividend or liquidation participation rights that enable the holder to participate in corporate growth to a significant extent (participating preferred stock), should continue to be subject to the stock repurchase excise tax. In the stakeholder's view, a redemption of such stock generally is more akin to a redemption of common stock than to a repayment of debt or a redemption of straight preferred stock (for example, there are fewer outstanding shares of stock participating in future corporate growth after such a redemption).

For the reasons stated in part II.A.1 of this Explanation of Provisions, the Treasury Department and the IRS agree with the stakeholder's recommendation. Accordingly, under the proposed regulations, the repurchase of convertible or participating preferred stock would be subject to the stock repurchase excise tax, and the issuance of such stock would be taken into account for purposes of the netting rule. *See* proposed §§ 58.4501–1(b)(29), 58.4501–2(e)(2), and 58.4501–4(b)(1).

3. Additional Tier 1 Preferred Stock

Several stakeholders noted that the issuance and redemption of preferred stock is used routinely in certain industries as a way to manage risk. One stakeholder recommended an exception to the stock repurchase excise tax and the netting rule for redemptions or issuances of preferred stock that qualifies as additional tier 1 capital for purposes of regulatory requirements for regulated financial institutions (additional tier 1 preferred stock).

According to the stakeholder, the issuing corporation may not redeem or repurchase additional tier 1 preferred stock without prior approval from regulators. Moreover, if such an instrument is callable by its terms, (i) it may not be called for at least five years; (ii) the issuing corporation must receive prior approval from regulators to exercise the call option; and (iii) the issuing corporation must either replace the instrument with other tier 1 capital or demonstrate to regulators that it will continue to hold capital commensurate with risk.

Based on the feedback received, the Treasury Department and the IRS are of the view that the stock repurchase excise tax regulations should not apply to additional tier 1 preferred stock. *See* proposed § 58.4501–1(b)(29)(ii). Consequently, under the proposed regulations, additional tier 1 preferred stock would not be subject to the stock repurchase excise tax, and the issuance of additional tier 1 preferred stock would not be taken into account for purposes of the netting rule.

4. Convertible Debt

Stakeholders have requested confirmation that redemptions of convertible debt instruments are not subject to the stock repurchase excise tax. One stakeholder contended that such transactions should not be treated as ''economically similar'' to a section 317(b) redemption because the definition of ''redemption'' in section 317(b) encompasses only redemptions of stock, and because a redemption of a convertible debt instrument does not reduce the number of a corporation's outstanding shares. Another stakeholder contended that the determination of whether an instrument constitutes debt or equity should be made at the time of issuance. Therefore, if the convertible debt instrument is characterized as ''debt'' at the time of issuance, the subsequent redemption or cash settlement of that instrument should not be treated as a repurchase. Likewise, the issuance of a convertible debt instrument by a covered corporation should not be treated as an issuance for purposes of the netting rule.

The Treasury Department and the IRS agree with these stakeholders. Although Notice 2023–2 does not expressly address convertible debt instruments, the Treasury Department and the IRS continue to be of the view that, for purposes of the stock repurchase excise tax, whether an instrument is debt or equity should be determined at the time of issuance under Federal income tax principles, and that this characterization should not be retested while the debt instrument is outstanding. *See* proposed § 58.4501–1(b)(29); *see also* part II.B of this Explanation of Provisions. Such an approach would better facilitate the IRS's ability to administer and enforce the stock repurchase excise tax and enable taxpayers to apply the tax with greater certainty. Moreover, the term ''repurchase'' includes only section 317(b) redemptions with regard to ''stock'' of a covered corporation as well as transactions that are ''economically similar'' to such redemptions. *See* section 4501(c)(1). Accordingly, the Treasury Department and the IRS are of the view that no special rules are needed for convertible debt. However, for a discussion of the application of the netting rule to an instrument not in the legal form of stock, *see* part XI.C.9 of this Explanation of Provisions.

5. Tracking Stock

Tracking stock is an instrument that tracks the performance of a division of the parent corporation or a subsidiary (for example, by providing dividend rights that are determined by reference

to the earnings of the tracked division or subsidiary). Because tracking stock participates in corporate growth, a stakeholder recommended treating the redemption of less than all shares of a class of tracking stock in the same manner as the redemption of other common stock—that is, as subject to the stock repurchase excise tax.

However, the stakeholder also suggested that an exemption may be warranted for the redemption of an entire class of tracking stock in connection with the disposition of the underlying tracked business, because such a redemption (i) does not accrete to the interests of the corporation's remaining shareholders in the corporation's remaining assets, and (ii) may be equivalent to a distribution in partial liquidation. (As discussed in part VI.B of this Explanation of Provisions, the stakeholder recommended treating partial liquidations as generally outside the scope of the stock repurchase excise tax.)

The Treasury Department and the IRS are of the view that the treatment of tracking stock for purposes of the stock repurchase excise tax should follow the general Federal tax treatment of tracking stock. Accordingly, no special guidance regarding the proper treatment of tracking stock is included in these proposed regulations.

B. Characterization of Instruments as Stock or Debt

One stakeholder requested confirmation that the determination of whether an instrument is stock or debt for purposes of the stock repurchase excise tax is made at the time of issuance under Federal tax principles, and that this characterization is not retested subsequently while the instrument is outstanding. The Treasury Department and the IRS agree with this recommendation, because, as previously stated, such an approach under which an instrument is tested only once would better facilitate the IRS's ability to administer and enforce the stock repurchase excise tax and enable taxpayers to apply the tax with greater certainty. *See* proposed § 58.4501–1(b)(29).

C. Options and Similar Financial Instruments

1. Overview

As discussed previously, Notice 2023–2 would define ''stock'' to mean any instrument issued by a corporation that is stock or that is treated as stock for Federal tax purposes at the time of issuance. *See* section 3.02(25) of Notice 2023–2. This definition of ''stock'' generally excludes options other than options that are treated as stock for Federal tax purposes at the time of issuance.

To the extent option contracts are not treated as stock at the time of issuance, the acquisition of such contracts is not a repurchase under Notice 2023–2 because such acquisition is neither a section 317(b) redemption nor included in the exclusive list of economically similar transactions in section 3.04(4)(a) of Notice 2023–2. Consequently, under Notice 2023–2, there is a repurchase or an issuance of stock only at the time of exercise of a physically settled option (when a covered corporation repurchases or issues the actual underlying stock). In turn, the amount of such repurchase or issuance is equal to the market price of the stock on the date the stock is repurchased or issued. *See* sections 3.06(1)(a), 3.06(2), 3.08(2), and 3.08(5) of Notice 2023–2; *see also* part III of this Explanation of Provisions (discussion of valuation and timing).

Several questions have arisen regarding the application of the stock repurchase excise tax to options and similar financial instruments. In section 6.02(4) of Notice 2023–2, the Treasury Department and the IRS requested comments on: (i) whether any additional rules with regard to financial arrangements, such as options or other similar financial instruments, should be added to prevent avoidance of the stock repurchase excise tax; and (ii) how such additional rules should apply consistently for purposes of determining a covered corporation's repurchases and issuances.

2. Physical Settlement of Option Contracts

Stakeholders recommended that the fair market value of shares acquired or issued (as appropriate) by a covered corporation upon physical settlement of an option contract should be the fair market value of the shares on the date of exercise, rather than the strike price (that is, the price at which the option can be exercised). For example (Example 1), assume that corporation X issues a call option to individual A that entitles A to buy 100 shares of X stock for $100 ($1.00 per share) from X for a limited time. The terms of the option require physical settlement. On the date the option is issued, X stock is trading at $1.00 per share. On the date the option is exercised, X stock is trading at $1.30 per share. Upon settlement of the option, A pays $100 to X, which issues 100 shares of X stock (worth $130) to A.

Alternatively (Example 2), assume the same facts as in Example 1, except that X issues a put option to A that entitles A to sell 100 shares of X stock for $100 ($1.00 per share) to X, and that X stock is trading at $0.70 per share on the date the option is exercised. To settle the option, X purchases 100 shares of X stock (worth $70) for $100 from A.

As another example (Example 3), assume that A issues a call option to unrelated individual B that entitles B to buy 100 shares of X stock for $100 ($1.00 per share) from A for a limited time. The terms of the option require physical settlement. Subsequently, X purchases the option contract from B. On the date the option is exercised, X stock is trading at $1.30 per share. To settle the option, X pays $100 to A, who delivers 100 shares of X stock (worth $130) to X.

The netting rule requires the stock repurchase excise tax base to be reduced by ''the fair market value of any stock issued by the covered corporation during the taxable year.'' *See* section 4501(c)(3). Thus, according to stakeholders, the amount of the issuance in Example 1 should be $130 (the fair market value of the stock at the time of issuance) even though A pays only $100 to excise the option.

Similarly, the stock repurchase excise tax applies to ''the fair market value of any stock of the corporation which is repurchased by such corporation during the taxable year.'' *See* section 4501(a). Consequently, stakeholders suggested that the amount of the repurchase in Example 2 should be $70, and that the $30 premium paid by X represents the amount paid for a property right separate from the stock being repurchased. *Cf.* Rev. Rul. 70–108, 1970–1 C.B. 78 (holding that the right to purchase additional shares constitutes separate property from the underlying shares). Consistent with this approach, stakeholders also suggested that the amount of the repurchase in Example 3 should be $130 (the fair market value of the stock on the exercise date).

The Treasury Department and the IRS agree with the stakeholders that the amount of the issuance in Example 1 should be $130 (the fair market value of the issued stock on the exercise date) rather than $100 (the strike price paid by A). Similarly, the Treasury Department and the IRS agree that the amount of the repurchase in Example 2 should be $70 rather than $100, and that the amount of the repurchase in Example 3 should be $130 rather than $100.

The foregoing approach, which is consistent with Notice 2023–2, is embedded in the proposed rules regarding the fair market value of repurchased or issued stock. *See* proposed §§ 58.4501–2(h)(1) and

58.4501–4(e)(1), respectively. Thus, the Treasury Department and the IRS are of the view that special rules are not needed with respect to the fair market value of stock repurchased or issued upon the physical settlement of an option. However, the proposed regulations would include several examples to illustrate the proposed approach. *See* proposed § 58.4501–5(b)(26) and (28). For special rules for valuing stock issued or provided to an employee or other service provider in connection with the performance of services, *see* proposed § 58.4501–4(e)(5) and part XI.G.7 of this Explanation of Provisions.

3. Cash Settlement of Option Contracts

As previously discussed in part II.C.2 of this Explanation of Provisions, stakeholders recommended treating the physical settlement of an option as a repurchase or an issuance (as appropriate) based on the fair market value of the stock repurchased or issued on the date of exercise. In contrast, a stakeholder recommended that the cash settlement of a put option issued by a covered corporation should not be treated as a repurchase by the covered corporation, because any excess of the strike price over the fair market value of the underlying stock should be viewed as payment for property that is separate from the underlying stock. *Cf.* Rev. Rul. 70–108.

For example, assume that corporation X issues a put option to individual A that entitles A to sell 100 shares of X stock for $100 ($1.00 per share) to X, and that X stock is trading at $0.70 per share on the date the option is exercised. The terms of the option require net cash settlement; thus, X pays $30 to A to settle the option. The stakeholder recommended not treating the net cash settlement as a repurchase, even though the settlement could be construed as a purchase by X of the 100 X shares from A for $100, immediately followed by an issuance by X of 100 shares to A for $70.

For the cash settlement of a call option, the stakeholder generally recommended either (i) treating the net cash settlement as a deemed issuance of stock immediately followed by a repurchase of the same stock (resulting in no net adjustment to the stock repurchase excise tax base), or (ii) simply disregarding the cash settlement altogether for purposes of the stock repurchase excise tax. For example, assume that X issues a call option to A that entitles A to buy 100 shares of X stock for $100 ($1.00 per share) from X, and that X stock is trading at $1.30 per share on the date the option is exercised. The terms of the option require net cash settlement; thus, X pays $30 to A to settle the option.

The net cash payment in the foregoing example is the economic equivalent of (i) A paying $100 to exercise the option, (ii) X issuing 100 shares (worth $130) to A, and then (iii) X immediately redeeming those shares for $130 in cash. Thus, X could be deemed to have issued and repurchased $130 of its shares in a transaction that fully offsets for purposes of the stock repurchase excise tax. Alternatively, X's net cash settlement could be disregarded altogether and simply treated as the sale or exchange of an option. *See* section 1234(c)(2); Rev. Rul. 88–31, 1988–1 C.B. 302 (providing that the net cash settlement of a price-protection contingent value right is treated as a cash settlement of a put option subject to section 1234(c)(2)).

The Treasury Department and the IRS are of the view that, for purposes of the stock repurchase excise tax, the net cash settlement of an option should not be treated as involving a deemed issuance and repurchase of shares in the interest of simplicity and administrability. Accordingly, under the proposed regulations, the net cash settlement of an option contract would result in neither the repurchase nor the issuance of stock other than as discussed in part II.C.4 of this Explanation of Provisions. This rule would apply to the net cash settlement of an embedded option (for example, if the issuer pays the investor solely in cash on exercise of the conversion right in a convertible bond). *See* proposed §§ 58.4501–2(e)(5)(v) and 58.4501–4(f)(12).

4. Deep-in-the-Money Options

Several stakeholders recommended that options that are treated as constructively exercised at the time of their grant under Federal income tax principles (commonly referred to as ''deep-in-the-money'' options) should be treated similarly for purposes of the stock repurchase excise tax. For example, according to the stakeholders, if the grant of an option is treated as the issuance of the underlying stock as of the date of the grant for Federal income tax purposes, the grant of the option should be treated as an issuance of stock for purposes of the netting rule, and the cash settlement of the option should be treated as a repurchase of stock in the year of the settlement.

The stakeholders further recommended that the determination of whether an option is deep in the money should be made only at the time of grant and generally should not be revisited. Thus, if a corporation grants a call option that is exercisable or convertible into the corporation's stock and that is not constructively exercised at the time of grant, the stock should not be treated as issued until the option is exercised or converted into stock.

The Treasury Department and the IRS are of the view that, if a deep-in-the-money option is determined to be constructively exercised at the time of grant under Federal income tax principles, the cash settlement of such an option would be a repurchase of the underlying stock on the date of settlement under the proposed regulations. *See* proposed § 58.4501–2(e)(5)(v). However, for a discussion of the application of the netting rule to deep-in-the-money options or other instruments not in the legal form of stock, *see* part XI.C.9 of this Explanation of Provisions.

5. Section 305(a) Warrants

A stakeholder recommended that, if an option to acquire a covered corporation's stock is distributed in a distribution under section 305(a) of the Code (section 305(a) warrant), the adjustment to the stock repurchase excise tax base upon settlement of the section 305(a) warrant should be determined by reference to the strike price (and not the value of the underlying stock) because the section 305(a) distribution should be disregarded.

The Treasury Department and the IRS are of the view that the treatment of warrants distributed in a section 305 distribution should not deviate from the treatment of other types of financial instruments under the proposed regulations. The Treasury Department and the IRS view this approach as facilitating the IRS's ability to administer and enforce the stock repurchase excise tax and enable taxpayers to apply the tax with greater certainty. Accordingly, the proposed regulations would not provide special rules for warrants distributed in a section 305 distribution. *See* proposed §§ 58.4501–2(e)(5)(v) and 58.4501–4(f)(12); *see also* part II.C.3 of this Explanation of Provisions (discussion of cash settlement of option contracts).

6. Integration of Qualifying Debt Instruments Under § 1.1275–6

A stakeholder requested clarification on how section 4501 applies to a synthetic debt instrument resulting from an integrated transaction under § 1.1275–6. In general, § 1.1275–6 provides for the integration of a qualifying debt instrument (as defined in § 1.1275–6(b)(1)) with a § 1.1275–6 hedge or combination of § 1.1275–6

hedges in certain circumstances. The circumstances in which § 1.1275–6 may apply involve a convertible debt instrument as well as one or more options or other financial instruments involving underlying stock, provided that the combined cash flows of the financial instrument and the debt instrument permit the calculation of a yield to maturity under section 1272 of the Code or the right to the combined cash flows would qualify as a specified type of variable rate debt instrument, and other conditions are satisfied.

Under § 1.1275–6(f), except as otherwise provided in published guidance, the synthetic debt instrument resulting from an integrated transaction is recognized as a single debt instrument for Federal income tax purposes for the period that the transaction qualifies as an integrated transaction and is not subject to the Federal income tax rules that would apply on a separate basis to the instruments comprising the integrated transaction if the transaction were not integrated.

Because an integrated transaction does not change the amount of stock actually repurchased or issued, the Treasury Department and the IRS are of the view that the determination of whether and when stock is repurchased or issued for purposes of the stock repurchase excise tax should be determined without regard to the integration of a qualifying debt instrument with a § 1.1275–6 hedge or combination of § 1.1275–6 hedges under § 1.1275–6. *See* proposed § 1.1275–6(f)(12)(iii).

D. Forfeiture or Clawback of Restricted Stock

One stakeholder recommended that the forfeiture of restricted stock (that is, stock transferred to a service provider that is subject to a substantial risk of forfeiture at grant) that was transferred to a service provider in connection with the performance of services should not be treated as a repurchase for purposes of the stock repurchase excise tax to the extent no payment is made to the service provider in connection with the forfeiture. Instead, the stakeholder recommended treating the stock as repurchased only to the extent of any payment received in connection with the forfeiture, with any excess of the value of the stock over the amount paid treated as a forfeiture. In other words, the stakeholder recommended using the amount paid rather than market price to compute the amount of the repurchase in this situation.

The stakeholder cited to § 1.83–6(c) in support of its recommendation. Section 1.83–6(c) provides that, if (under section 83(h) of the Code and § 1.83–6(a)) a deduction, an increase in basis, or a reduction of gross income was allowable to an employer in respect of a transfer of property, and if such property subsequently is forfeited, then the amount of such deduction, increase in basis, or reduction of gross income is included in the employer's gross income for the taxable year in which the forfeiture occurs. According to the stakeholder, the fact that the employer does not recognize additional income or gain suggests that the property forfeited, to the extent it exceeds any amount paid by the employer to the forfeiting service provider, is treated as a capital contribution to the employer under section 118(a) rather than as a redemption.

Notice 2023–2 does not expressly address the forfeiture of restricted stock. Under section 3.06(2) of Notice 2023–2, if property is paid for the forfeited stock, the stock is treated as repurchased for an amount equal to the market price on the date of repurchase (regardless of the amount actually paid) because there is a section 317(b) redemption. If no property is paid in exchange for the forfeited shares, the forfeiture is not treated as a repurchase, because the forfeiture is neither a section 317(b) redemption nor treated as an economically similar transaction. However, under both Notice 2023–2 and these proposed regulations, there would be an issuance for purposes of the netting rule when the ownership of the restricted stock transfers to the recipient for Federal income tax purposes. *See* proposed § 58.4501–4(d)(2).

The Treasury Department and the IRS are of the view that, if a covered corporation takes into account an issuance of restricted stock for purposes of the netting rule because a section 83(b) election has been made, a forfeiture of such stock likewise should be treated as a repurchase. Conversely, if a covered corporation does not take into account an issuance of restricted stock for purposes of the netting rule, a forfeiture of such stock should not be treated as a repurchase. This approach is necessary to preserve consistency in the treatment of issuances and repurchases. Moreover, the economic effect of a forfeiture is similar to that of a repurchase, insofar as the shares are retired (or held as treasury stock) in both cases.

Accordingly, the proposed regulations would treat a forfeiture of restricted stock as a repurchase on the date of forfeiture (in an amount equal to the fair market value of such stock on the date of forfeiture) if such forfeited stock was treated as issued or provided under the netting rule. *See* proposed § 58.4501–2(e)(4)(vi); *see also* part XII.D of this Explanation of Provisions (discussion of a proposal to provide similar treatment with regard to forfeitures of stock issued as part of an earnout or to satisfy an indemnification obligation).

It is the view of the Treasury Department and the IRS that stock received by a covered corporation or specified affiliate pursuant to a clawback agreement (that is, a contractual provision that requires an employee to return vested stock) is economically similar to restricted stock forfeited to the covered corporation after failure to vest. Accordingly, these proposed regulations also would provide that, if the stock were treated as issued or provided under the netting rule, then the clawed back stock would be treated as repurchased on the date of clawback (in an amount equal to the fair market value of such stock on such date). *See* proposed § 58.4501–2(e)(4)(vi).

III. Valuation and Timing

A. Valuation

1. Overview

Under sections 3.06(2) and 3.08(5) of Notice 2023–2, the fair market value of stock repurchased or issued (other than stock issued or provided to an employee) is the market price of the stock on the date the stock is repurchased or issued, respectively. Thus, if the price at which the repurchased stock is purchased differs from the market price of the stock on the date the stock is repurchased, the fair market value of the stock is the market price on the date the stock is repurchased.

The Treasury Department and the IRS continue to be of the view that this approach is more consistent with the plain language of the statute, and simpler for the IRS to administer and for taxpayers to apply, than an approach that defines fair market value by reference to the amount paid to repurchase stock. For example, under Notice 2023–2, adjustments are not required for transaction costs or non-arm's-length transactions, and special rules are not needed for situations in which stock is redeemed for consideration other than cash (such as a non-publicly traded note).

Section 3.08(3)(c) of Notice 2023–2 describes a special rule for valuing stock issued or provided to employees. The fair market value of such stock is the fair market value of the stock, as determined under section 83, as of the date the stock is issued or provided to the employee, as determined under section 3.08(3)(b)

of Notice 2023–2. *See* part XI.G.7 of this Explanation of Provisions (discussion of valuing stock issued or provided to an employee or other service provider).

In section 6.01(2) of Notice 2023–2, the Treasury Department and the IRS requested comments on whether the fair market value of stock repurchased or issued should be an amount other than the market price of such stock. In section 6.01(6) of Notice 2023–2, the Treasury Department and the IRS also requested comments on whether a method should be provided for determining the market price of stock that is traded on multiple established securities markets and, if so, what modifications to the rules described in sections 3.06(2)(a)(i) and 3.08(5)(a)(i) of Notice 2023–2 (concerning acceptable methods for determining the market price of repurchased or issued stock that is traded on an established securities market) would be required.

2. Valuation in Arm's-Length Transactions

Consistent with the approach described in Notice 2023–2, stakeholders generally recommended that the fair market value of stock repurchased or issued should be the market price of the stock on the day of the repurchase or issuance, respectively. However, one stakeholder also recommended that covered corporations be required to determine fair market value based on the actual price the covered corporation pays or receives, if the repurchase or issuance is (i) from or to an unrelated party, (ii) for cash or cash-equivalents, (iii) negotiated at arm's length, and (iv) not pursuant to a pre-existing option contract or other arrangement (for example, an accelerated share repurchase agreement) that involves the delivery of stock at a price other than the stock's market price at delivery.

Similarly, another stakeholder recommended an exception to the general fair market value rule for repurchases that result from a tender offer or other, similarly negotiated transaction that sets a transaction price prior to the closing date. According to the stakeholder, it is common for the transaction price and the market price on the closing date to differ, and it is not clear why the value of a repurchase should be determined based on the market price rather than the transaction price.

The Treasury Department and the IRS continue to be of the view that an approach that references the market price of stock on the date the stock is repurchased or issued, respectively, is more consistent with the plain language of the statute, and would be simpler to administer, than an approach that references the amount paid to repurchase the stock. Moreover, the Treasury Department and the IRS are of the view that the two approaches likely would result in approximately similar values for most repurchases of publicly traded stock. Consequently, the proposed regulations would provide that the fair market value of stock repurchased or issued is the market price of the stock on the date the stock is repurchased or issued, respectively. *See* proposed §§ 58.4501–2(h)(1) and 58.4501–4(e)(1).

3. Valuation in Bankruptcy or Insolvency Workouts

Another stakeholder recommended that, in the case of a bankruptcy or insolvency workout, the fair market value of repurchased stock should equal the value of the recovery shareholders are entitled or permitted to receive under the bankruptcy or insolvency workout, rather than the market price of the stock. The stakeholder recommended this approach because the market price of the stock will take the debt restructuring into account and, thus, may be much higher than the recovery value.

However, the Treasury Department and the IRS are of the view that the proposed regulations should not adopt special valuation rules for financially troubled companies. As discussed in part XIII of this Explanation of Provisions, the Treasury Department and the IRS are of the view that distributions of cash or other non-qualifying property (that is, property that is not permitted to be received under section 354 or 355 of the Code without the recognition of gain or loss) by troubled companies to their shareholders in exchange for their stock should be subject to the stock repurchase excise tax. Moreover, section 4501 contains no indication that special valuation rules for financially troubled companies would be necessary or appropriate to carry out the purposes of the stock repurchase excise tax. The Treasury Department and the IRS are of this view because the exchange would be a section 317(b) redemption and providing a special rule would not be necessary or appropriate to carry out the purposes of section 4501.

4. Valuation of Publicly Traded Stock

a. In General

One stakeholder recommended that taxpayers be permitted (but not required) to determine the market price of publicly traded stock based on one or more commonly accepted valuation methods, such as daily volume-weighted average price (VWAP), daily average high-low price, or daily closing price. Under the stakeholder's recommendation, a taxpayer would be required to consistently apply the taxpayer's chosen method to all its repurchases and issuances throughout the taxpayer's taxable year. According to the stakeholder, this approach would be consistent with established Federal tax valuation standards for the fair market value of publicly traded securities.

Sections 3.06(2)(a)(i) and 3.08(5)(a)(i) of Notice 2023–2 describe an approach that would require taxpayers to determine the market price of repurchased or issued stock, respectively, that is traded on an established securities market by applying one of four methods: (i) the daily volume-weighted average price as determined on the date the stock is repurchased or issued; (ii) the closing price on the date the stock is repurchased or issued; (iii) the average of the high and low prices on the date the stock is repurchased or issued; and (iv) the trading price at the time the stock is repurchased or issued. Sections 3.06(2)(a)(iii) and 3.08(5)(a)(iii) of Notice 2023–2 describe an approach that would require the market price of such stock to be determined by consistently applying one of the foregoing methods to all repurchases and issuances throughout the covered corporation's taxable year (other than stock issued to employees). Another stakeholder expressed appreciation for the flexibility provided under the approach described in sections 3.06(2)(a) and 3.08(5)(a) of Notice 2023–2.

The Treasury Department and the IRS agree that commonly accepted valuation methods are an appropriate means of determining the fair market value of publicly traded stock for purposes of repurchases and issuances under section 4501. Accordingly, consistent with Notice 2023–2, the proposed regulations would include four such methods: (i) daily VWAP; (ii) daily closing price; (iii) daily average high-low price; and (iv) trading price when stock is repurchased or issued. Consistent with Notice 2023–2, to facilitate the IRS's ability to administer and enforce the stock repurchase excise tax, the Treasury Department and the IRS are of the view that taxpayers should be required (rather than merely permitted) to use one of these methods. *See* proposed §§ 58.4501–2(h)(2)(ii) and 58.4501–4(e)(2)(ii).

As reflected in sections 3.06(2)(a)(iii) and 3.08(5)(a)(iii) of Notice 2023–2, the

Treasury Department and the IRS also agree with the stakeholder that taxpayers should be required to consistently apply the chosen method to all repurchases and issuances throughout the taxable year. *See* proposed §§ 58.4501–2(h)(2)(iv) and 58.4501–4(e)(2)(iv). For special rules for valuing stock issued or provided to an employee or other service provider in connection with the performance of services, *see* proposed § 58.4501–4(e)(5) and part XI.G.7 of this Explanation of Provisions.

b. Stock Traded on Multiple Established Securities Markets

One stakeholder recommended that a covered corporation with a class of stock that trades on multiple established securities markets should be permitted to select both the valuation method and the exchange to be used in determining the fair market value of the covered corporation's stock. The stakeholder had considered an alternative approach based on the market price of the shares on the exchange with the highest trading volume on the applicable date, but the stakeholder did not recommend such an approach due to the additional complexity it would create.

The Treasury Department and the IRS are of the view that a covered corporation whose stock is traded on multiple exchanges should determine the fair market value of the covered corporation's stock by reference to trading on the exchange in the country in which the covered corporation is organized, including a regional established securities market that trades in that country. If the covered corporation's stock trades on multiple exchanges in the country in which the covered corporation is organized, fair market value is determined by reference to trading on the exchange in that country with the highest trading volume in that stock in the prior taxable year. *See* proposed §§ 58.4501–2(h)(2)(v) and 58.4501–4(e)(2)(v). It is the view of the Treasury Department and the IRS that this approach would better facilitate the IRS's ability to administer and enforce the stock repurchase excise tax and enable taxpayers to apply the tax with greater certainty.

5. Valuation of Privately Owned Stock

One stakeholder recommended that the market price of privately owned stock should be determined under general valuation principles for privately owned securities. Another stakeholder recommended that the market price of privately owned stock should equal the amount paid for such stock. According to this second stakeholder, valuation experts often disagree, and the transaction price typically is viewed as the best evidence of the value of privately owned stock. Further, allowing corporations to use the amount paid in valuing privately traded stock would relieve corporations from the need to evaluate whether there is a difference between the amount paid and the market price of such shares on the date on which ownership transfers for Federal income tax purposes.

Under the approach described in sections 3.06(2)(b) and 3.08(5)(b) of Notice 2023–2, stock that is not traded on an established securities market would be valued on the date of repurchase or issuance under the principles of § 1.409A–1(b)(5)(iv)(B)(*1*). Section 1.409A–1(b)(5)(iv)(B)(*1*) provides, in part, that the fair market value of stock as of a valuation date means a value determined by the reasonable application of a reasonable valuation method, and that the determination of whether a valuation method is reasonable (or whether an application of a valuation method is reasonable) is made based on the facts and circumstances as of the valuation date. Section 1.409A–1(b)(5)(iv)(B)(*1*) further provides that the amount paid is one factor to be considered under a reasonable valuation method. The Treasury Department and the IRS are of the view that the proposed regulations should implement the approach described in Notice 2023–2 and should not provide a separate rule that would permit taxpayers to use the amount paid, in and of itself, in determining the value of privately traded stock. *See* proposed §§ 58.4501–2(h)(3) and 58.4501–4(e)(3). For special rules for valuing stock issued or provided to an employee or other service provider in connection with the performance of services, *see* proposed § 58.4501–4(e)(5) and part XI.G.7 of this Explanation of Provisions.

As with publicly traded stock, the Treasury Department and the IRS are of the view that repurchases and issuances of privately traded stock should be valued consistently. Specifically, the proposed regulations would provide that the same valuation method must be used for all repurchases and issuances of privately owned stock belonging to the same class throughout the covered corporation's taxable year, unless the application of that method to a particular repurchase or issuance would be unreasonable under the facts and circumstances as of the valuation date. *See* proposed §§ 58.4501–2(h)(3)(ii) and 58.4501–4(e)(3)(ii). For special rules for valuing stock issued or provided to an employee or other service provider in connection with the performance of services, *see* proposed § 58.4501–4(e)(5) and part XI.G.7 of this Explanation of Provisions.

6. Annual Valuation Convention

A stakeholder also questioned whether covered corporations should be permitted to use an annual valuation convention to determine a single, uniform value for all repurchases and issuances during a taxable year. According to the stakeholder, an annual valuation convention would eliminate the distortive effects of stock price volatility. In addition, such approach would simplify netting because the use of the same price for all repurchases and issuances in the taxable year would allow netting to be computed based on the number of shares repurchased versus issued.

However, the stakeholder also acknowledged that converting the netting rule into such a ''share count'' rule would be in tension with the statutory requirement to value shares based on fair market value. The stakeholder also noted that volatility later in the year could cause a covered corporation's stock repurchase excise tax liability to rise or fall dramatically after issuances or repurchases earlier in the year, and that other Code provisions typically do not allow values to be averaged over such a long period.

The Treasury Department and the IRS agree with the stakeholder that adoption of an annual valuation convention in the proposed regulations would be inconsistent with the statutory requirement under section 4501(c)(3) to value shares based on fair market value. Accordingly, the proposed regulations would not adopt the stakeholder's annual valuation convention.

B. Timing of Issuances and Repurchases

1. In General

The approach described in sections 3.06(1)(a) and 3.08(2) of Notice 2023–2 generally provides that stock is treated as repurchased or as issued or provided, respectively, at the time at which ownership of the stock transfers for Federal income tax purposes. In turn, the approach described in sections 3.06(2) and 3.08(5) of Notice 2023–2 provides that the fair market value of stock repurchased or issued is the market price of the stock on the date the stock is repurchased or issued, respectively.

One stakeholder recommended that, consistent with the approach described in section 3.08(2) of Notice 2023–2, stock generally should be treated as issued for purposes of the netting rule

when tax ownership of the stock transfers to the recipient of the stock, rather than when the stock is issued for corporate law or financial statement purposes.

The Treasury Department and the IRS agree with the stakeholder's general recommendation and continue to be of the view that stock generally should be treated as repurchased when tax ownership of the stock transfers to the covered corporation or to the specified affiliate (as appropriate). Therefore, the proposed regulations generally would retain this approach. *See* proposed §§ 58.4501–2(g)(1) and 58.4501–4(d)(1). For specific timing rules applicable in particular situations, *see* proposed § 58.4501–2(g)(2), (3), and (4), and for special timing rules for stock issued or provided to an employee or other service provider in connection with the performance of services, *see* proposed § 58.4501–4(d)(2) and part XI.G.6 of this Explanation of Provisions.

2. Repurchase Pursuant to an Economically Similar Transaction

Under the rule described in section 3.06(1)(b) of Notice 2023–2, stock repurchased in an economically similar transaction is treated as repurchased when the shareholders of the covered corporation exchange their stock in the covered corporation. Consistent with part III.B.1 of this Explanation of Provisions and section 3.06(1)(b) of Notice 2023–2, the proposed regulations would provide that stock repurchased in an economically similar transaction described in proposed § 58.4501–2(e)(4) is treated as repurchased on the date the shareholders of the covered corporation exchange their stock in such corporation. *See* proposed § 58.4501–2(g)(2).

3. Repurchase Pursuant to a Constructive Specified Affiliate Acquisition

For a discussion of the timing rule for repurchases pursuant to a constructive specified affiliate acquisition, *see* part XIV.D of this Explanation of Provisions.

4. Accelerated Share Repurchase Agreements

Although Notice 2023–2 does not describe special rules for accelerated share repurchase (ASR) agreements, section 3.09(15), *Example 15,* of Notice 2023–2 illustrates the application of the timing rules summarized in part III.B.1 of this Explanation of Provisions in the context of an ASR agreement. That example explicitly is limited to situations in which, based on the terms of the agreement and the facts and circumstances, the date on which shares are delivered by the bank to the covered corporation is the date on which tax ownership of the shares is transferred for Federal income tax purposes. As a result, the delivery date in the example is the repurchase date. The example illustrates the general principle that the date on which tax ownership of the shares is transferred for Federal income tax purposes, which is generally based on the particular ASR agreement and the facts and circumstances of a transaction, is the repurchase date.

Several stakeholders requested guidance regarding the treatment of ASR agreements for purposes of the stock repurchase excise tax. In an ASR agreement, a corporation that wants to repurchase its outstanding shares from the market will make an initial cash payment to an investment bank in exchange for a certain number of shares. To deliver the shares to the corporation, (i) the investment bank first will borrow shares from stock lenders, and then (ii) over the term of the ASR agreement, the bank will purchase shares from the market and use such shares to gradually return the stock owed to the stock lenders.

The price the corporation ultimately pays for its shares under the ASR agreement generally is based on an averaging of the VWAP of the shares on specified days over the term of the agreement. Upon final settlement of the agreement, the bank may be required to deliver additional shares or cash to the corporation, or the corporation may owe additional purchase price to the bank, depending on the VWAP of the shares over the term of the agreement.

Several stakeholders recommended treating the initial delivery of shares by the bank to a covered corporation under an ASR agreement as a repurchase at the time of delivery, rather than at the time the bank purchases the shares from the market. Based on the plain language of section 4501(a), one stakeholder also recommended determining the amount of the repurchase by reference to the fair market value of the shares delivered on the date of delivery, rather than by reference to the initial payment amount under the ASR agreement. If the bank delivers additional shares to the covered corporation (or the covered corporation issues shares to the bank) upon final settlement of the ASR agreement, the stakeholder recommended that such delivery (or issuance) also should be considered as a repurchase (or an issuance) of shares for purposes of the stock repurchase excise tax, with the fair market value of the repurchase (or issuance) determined on that date.

The stakeholders' recommendations are consistent with Notice 2023–2, including section 3.09(15), *Example 15,* to the extent that the ASR agreement involved is one in which the date the shares are delivered by the bank to the covered corporation is the date on which tax ownership of shares is transferred for Federal income tax purposes. In such a situation, the date the shares are delivered would be the repurchase date. However, because the determination of the date on which tax ownership of shares is transferred is an inherently factual question, the Treasury Department and the IRS are of the view that no special rule should be included in the proposed regulations to determine the repurchase date for ASR agreements, and the proposed regulations would retain the approach described in Notice 2023–2. *See* proposed §§ 58.4501–2(h)(1), 58.4501–4(e)(1), and 58.4501–5(b)(15) (*Example 15*).

5. Other Forward Contracts

A stakeholder also requested guidance on how the stock repurchase excise tax applies to other forward transactions (either variable or fixed price) in which a corporation agrees to acquire or issue its stock for delivery in a future trade. The stakeholder recommended that the stock repurchase excise tax and the netting rule generally should be applied based on the fair market value of the shares at the time of their actual acquisition or issuance by the corporation. However, if the stock underlying the transaction is treated as immediately acquired or issued under Federal income tax principles (for example, if the corporation effectively acquires the benefits and burdens of stock ownership upon entering into the forward contract), the timing rules for purposes of the stock repurchase excise tax (for example, the date used for determining fair market value) should follow those Federal income tax principles.

The Treasury Department and the IRS agree with these recommendations as they relate to the determination of the date stock is treated as repurchased and the fair market value of that stock. As previously discussed, the proposed regulations generally would use Federal income tax principles to determine the date on which stock is treated as repurchased or issued. Additionally, under the proposed regulations, the fair market value of stock repurchased or issued generally would equal the market price of the stock on the date the stock is repurchased or issued. *See* proposed §§ 58.4501–2(h)(1) and 58.4501–4(e)(1). For a discussion of the application of the netting rule to forward contracts or other instruments not in the legal form

of stock, *see* part XI.C.9 of this Explanation of Provisions.

6. Stock Issued or Provided to an Employee or Other Service Provider

For a discussion of the timing rules for stock issued or provided to an employee or other service provider, *see* part XI.G.6 of this Explanation of Provisions.

IV. Definitions of ''Covered Corporation,'' ''Established Securities Market,'' and ''Specified Affiliate''

A. Becoming or Ceasing To Be a Covered Corporation

1. Overview

In section 6.02(2) of Notice 2023–2, the Treasury Department and the IRS requested comments on when a corporation should be treated as becoming or ceasing to be a covered corporation, and how repurchases and issuances by a corporation during a taxable year that are prior to the date the corporation becomes a covered corporation or after the date the corporation ceases to be a covered corporation should be treated. For example, the Treasury Department and the IRS have considered the extent to which the term ''covered corporation'' should apply to a privately held corporation that goes public, or to a publicly traded corporation that goes private, during a taxable year.

One stakeholder recommended that the stock repurchase excise tax base of a corporation that becomes a covered corporation during its taxable year (for example, because of an initial public offering (IPO)) should be increased only for section 317(b) redemptions and economically similar transactions occurring on or after the date the corporation becomes a covered corporation. The stakeholder further recommended that only stock issued by a corporation on or after the date it becomes a covered corporation should be taken into account for purposes of the netting rule.

Similarly, another stakeholder recommended that a corporation's status as a covered corporation should be determined immediately prior to a repurchase transaction. Thus, for example, a public corporation that becomes a private corporation in a repurchase would be a covered corporation with respect to that transaction.

In contrast, another stakeholder recommended that any redemption that occurs as part of a transaction should be exempt from the definition of ''repurchase'' if the corporation's stock no longer is traded on an established securities market immediately after the transaction. Alternatively, the stakeholder recommended that a corporation's status as a covered corporation be determined at the end of the repurchase transaction.

2. General Rules

The Treasury Department and the IRS are of the view that, as a general rule, a corporation should be treated as a covered corporation starting at the beginning of the corporation's ''initiation date,'' which is the date on which stock of the corporation begins to be traded on an established securities market. Based on the statutory language, the Treasury Department and the IRS are of the view that the traded instrument must be stock of the corporation (as opposed to, for example, ''when-issued'' trading of interests in to-be-issued shares of stock of the corporation). *See,* for example, section 4501(b) (defining a covered corporation as a domestic corporation the *stock* of which is traded on an established securities market). A covered corporation generally would cease being treated as a covered corporation at the end of the covered corporation's ''cessation date,'' which is the date on which stock of the covered corporation ceases to be traded on an established securities market.

The Treasury Department and the IRS are of the view that these general rules would be consistent with the statutory language in section 4501 and would facilitate the IRS's ability to administer and enforce the stock repurchase excise tax. Accordingly, the proposed regulations would incorporate these general rules. *See* proposed § 58.4501–2(d)(1) and (d)(2)(i).

Under the proposed regulations, in the case of a privately held domestic corporation that goes public, shares issued on or after the initiation date would be counted for purposes of the netting rule under the proposed regulations. In addition, the proposed regulations would provide that any repurchases, issuances, or contributions to an employer-sponsored retirement plan on or after that date would be taken into account in computing the corporation's stock repurchase excise tax base for that taxable year. In contrast, shares issued before the initiation date would not be counted for purposes of the netting rule, and any repurchases, issuances, or contributions to an employer-sponsored retirement plan before that date would not be taken into account in computing the corporation's stock repurchase excise tax base for that taxable year. *See* proposed § 58.4501–4(b)(2).

In the case of a publicly traded domestic corporation that goes private, repurchases of stock on the cessation date would be subject to the stock repurchase excise tax under the proposed regulations, unless one of the statutory exceptions applies. However, any repurchases, issuances, or contributions to an employer-sponsored retirement plan of the corporation's stock after that date generally would not be taken into account under the proposed regulations in computing the corporation's stock repurchase excise tax base for that year.

3. Exception Regarding Cessation Transactions That Include Repurchases Pursuant to the Transaction's Plan

The proposed regulations would contain an exception to the general rule that a corporation should be treated as a covered corporation starting at the beginning of its ''initiation date'' and ending at the end of its ''cessation date.'' Under the proposed regulations, if a corporation ceases to be a covered corporation pursuant to a plan that includes a repurchase, and if the corporation's cessation date precedes the date on which any repurchase undertaken pursuant to the plan occurs, then the corporation would continue to be a covered corporation until the end of the date on which the repurchase occurs. *See* proposed § 58.4501–2(d)(2)(ii). For example, under the proposed regulations, all repurchases of stock of a target covered corporation in an acquisitive reorganization would be subject to the stock repurchase excise tax (if no exception applied), even if the target covered corporation's stock ceased to be traded on an established securities market prior to the repurchase of the target covered corporation's stock in the acquisitive reorganization. Under this exception, a covered corporation's final repurchase transaction pursuant to the plan of reorganization would be included in the stock repurchase excise tax base.

4. Inbound and Outbound F Reorganizations

A stakeholder requested clarification that, consistent with the Federal income tax treatment of a foreign corporation that domesticates in an F reorganization, such a corporation is not a domestic corporation for purposes of the stock repurchase excise tax until the day after that reorganization occurs. *See* § 1.367(b)–2(f)(4) (providing that, in the case of an F reorganization in which the transferor corporation is a foreign corporation, the taxable year of such corporation ends with the close of the date of the transfer). According to the

stakeholder, this clarification is important for foreign special acquisition holding companies, which typically domesticate when combining with a domestic business.

The Treasury Department and the IRS agree with the stakeholder. Accordingly, these proposed regulations would clarify that, for purposes of the stock repurchase excise tax, a foreign corporation that transfers its assets to a domestic corporation in an F reorganization (as described in § 1.367(b)–2(f)) is not treated as a domestic corporation until the day after the reorganization. Similarly, the proposed regulations would clarify that, for purposes of the stock repurchase excise tax, a domestic corporation that transfers its assets to a foreign corporation in an F reorganization (as described in § 1.367(a)–1(e)) is not treated as a foreign corporation until the day after the reorganization. *See* proposed § 58.4501–2(d)(3).

5. Determination of Timing of Events or Transactions

The Treasury Department and the IRS have considered rules to address uncertainty that could arise from the application of the stock repurchase excise tax regulations to a series of transactions or events that occurs across multiple time zones.

The Treasury Department and the IRS request comments on this issue, including specific proposals to address the application of the stock repurchase excise tax regulations to a series of transactions or events that occurs across multiple time zones. The Treasury Department and the IRS encourage comments regarding the extent to which a proposed approach would facilitate taxpayer certainty and the IRS's ability to administer and enforce the stock repurchase excise tax regulations.

B. Determining Specified Affiliate Status

If a specified affiliate of a covered corporation acquires stock of the covered corporation from a person that is not the covered corporation or another specified affiliate of the covered corporation, the acquisition is treated as a repurchase of the stock of the covered corporation by the covered corporation. *See* section 4501(c)(2)(A); *see also* section 3.05(1) of Notice 2023–2.

Stakeholders have asked when specified affiliate status should be determined. More specifically, stakeholders have asked when valuations should be undertaken for purposes of the 50-percent vote-or-value test in section 4501(c)(2)(B), and whether fluctuations in the value of the (potential) specified affiliate's stock or partnership interests should be ignored.

The Treasury Department and the IRS are of the view that the determination of whether a corporation or partnership is a specified affiliate should be made whenever such determination is relevant for purposes of section 4501. For example, such a determination would be relevant when the potential specified affiliate acquires stock of a covered corporation or provides stock of the covered corporation to employees of the potential specified affiliate. *See* proposed § 58.4501–2(f)(2)(i).

C. Involvement Safe Harbor

As defined in section 4501(b), the term ''covered corporation'' means any domestic corporation the stock of which is traded on an established securities market (within the meaning of section 7704(b)(1)). The rule described in section 3.02(13) of Notice 2023–2 further provides that the term ''established securities'' market has the meaning provided in § 1.7704–1(b).

Section 1.7704–1(b) provides, in part, that the term ''established securities market'' includes ''[a]n interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise'' (interdealer system). *See* § 1.7704–1(b)(5). However, § 1.7704–1(d) provides a safe harbor (involvement safe harbor) under which interests in a partnership are not treated as traded on an established securities market within the meaning of § 1.7704–1(b)(5) (that is, a partnership will not be a publicly traded partnership solely due to an interdealer system), unless the partnership either (1) ''participates in the establishment of the market or the inclusion of its interests thereon,'' or (2) ''recognizes any transfers made on the market'' by redeeming the transferor or admitting the transferee as a partner or otherwise recognizing any rights of the transferee.

A stakeholder noted that shares of corporations may trade over the counter (OTC) or on similar markets, even without the corporation's involvement, and that certain of those OTC or similar markets may qualify as an interdealer system. As a result, a corporation could be a covered corporation due to independent shareholder actions without the corporation engaging in an affirmative listing on an exchange. The stakeholder requested confirmation that the involvement safe harbor in § 1.7704–1(d) applies for purposes of determining whether a corporation is a covered corporation due to an interdealer system, with adjustments as needed for application of this safe harbor to corporations rather than partnerships.

The Treasury Department and the IRS are of the view that the involvement safe harbor should not apply for purposes of the stock repurchase excise tax. The Treasury Department and the IRS view the relationship between a partnership and its partners (a contractual relationship that allows a partnership to set the terms under which interests in the partnership may be validly transferred) as different from the relationship between a corporation and its shareholders (which is determined by the corporate law governing the stock). Accordingly, the proposed regulations would not incorporate the involvement safe harbor.

D. Indirect Ownership of Specified Affiliates

As noted in part I.B of the Background section of this preamble, section 4501(c)(2)(B) defines the term ''specified affiliate'' to mean, with regard to any corporation, ''(i) any corporation more than 50 percent of the stock of which is owned (by vote or by value), *directly or indirectly,* by such corporation, and (ii) any partnership more than 50 percent of the capital interests or profits interests of which is held, *directly or indirectly,* by such corporation'' (*emphasis added*).

The proposed regulations would provide that, for purposes of section 4501(c)(2)(B), ''indirect'' ownership means a corporation's proportionate ownership in equity interests through other entities. *See* proposed § 58.4501–2(f)(2)(ii). For example, if P owns 60 percent of the stock of Sub 1, which owns 60 percent of the stock of Sub 2, then P indirectly owns 36 percent ($0.6 \times 0.6 = 0.36$) of the stock of Sub 2.

E. Foreign Securities Markets

In section 6.02(9) of Notice 2023–2, the Treasury Department and the IRS requested comments on whether the definition of ''established securities market'' should be revised to clarify the regulatory requirements under the Securities Exchange Act of 1934 that are most relevant to the determination of whether a foreign securities market is treated as an established securities market and, if so, what type of U.S. securities exchange (including which tier of a securities exchange with multiple tiers) should be the baseline for comparison.

One stakeholder recommended including an exclusive list of foreign securities markets that are treated as established securities markets, on the grounds that tax advisors should not be required to determine whether foreign securities markets have regulatory

requirements analogous to those under the Securities Exchange Act of 1934. *See* § 1.7704–1(b).

The Treasury Department and the IRS appreciate the stakeholder's recommendation. However, the Treasury Department and the IRS are of the view that the development and maintenance of an exclusive list of foreign securities markets that are treated as established securities markets would be outside the scope of the proposed regulations. As a result, the proposed regulations would not include such a list.

F. Depository Receipts

In section 6.02(10) of Notice 2023–2, the Treasury Department and the IRS requested comments on how the trading of stock through depository receipts should be treated for purposes of determining whether a corporation is a covered corporation or whether repurchased stock is traded on an established securities market. In response, one stakeholder noted that some applicable foreign corporations with domestic specified affiliates have American depository receipts (ADRs) listed in the United States. The stakeholder requested guidance to clarify that the foreign parent's ADRs would not cause the domestic specified affiliate to be treated as if the domestic specified affiliate's stock were traded on an established securities market in the United States.

The Treasury Department and the IRS are of the view that no special rules are needed in response to this request. Section 4501(b) specifically defines the term ''covered corporation'' to mean ''any *domestic corporation the stock of which* is traded on an established securities market'' (*emphasis added*). Moreover, although Notice 2023–2 does not expressly address ADRs, the definition of ''stock'' is defined with respect to an instrument issued *by the corporation. See* section 3.02(25) of Notice 2023–2. The proposed regulations would maintain this definition of ''stock.'' *See* proposed § 58.4501–1(b)(29).

ADRs that provide full voting rights with respect to the underlying corporate stock, entitle ADR holders to receive any dividends paid on the stock, and permit an ADR holder to surrender an ADR at any time in exchange for the underlying stock, may be treated as direct ownership of the underlying stock. *See* Rev. Rul. 65–218, 1965–2 C.B. 566. If an ADR is not treated as direct ownership of the underlying stock, it would be characterized in accordance with its substance. In either case, because ADRs are not issued by a domestic specified affiliate, they would not be treated as stock of the domestic specified affiliate.

Publicly available information indicates that many foreign issuers treat ADRs for Federal income tax purposes as direct ownership of their stock. On that basis, under the definition of ''stock'' in these proposed regulations, ADRs would be treated as stock of the issuer and would be relevant to determining whether the *issuer* has stock that is traded on an established securities market. Similarly, global depositary receipts (GDRs) for the stock of domestic corporations that are traded on foreign exchanges may be relevant in determining whether the *issuer* has stock that is traded on an established securities market. Because the ADRs and GDRs are not issued by a domestic specified affiliate, they would not be treated as stock of the domestic specified affiliate.

Additionally, Congress specifically wrote rules to address situations involving a publicly traded foreign corporation with a domestic specified affiliate, and those rules do not include any provisions treating the domestic specified affiliate as publicly traded as a result of the foreign corporation's stock trading on an established securities market in the United States. *See* section 4501(d); *see also* part XVI of this Explanation of Provisions (discussion of feedback relating to section 4501(d)).

V. Section 301 Distributions

Section 301(a) of the Code generally provides that a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock is treated in the manner provided in section 301(c). Section 301(c)(1) provides that the portion of the distribution that is a dividend (as defined in section 316) is included in gross income. Section 301(c)(2) provides that the portion of the distribution that is not a dividend is applied against and reduces the adjusted basis of the stock. Section 301(c)(3) generally provides that the portion of the distribution that is not a dividend is treated as gain from the sale or exchange of property to the extent that it exceeds the adjusted basis of the stock.

For purposes of this discussion, an actual distribution subject to section 301(c)(2) or (3) refers to a distribution of property to a shareholder with respect to the corporation's stock that does not include an exchange of such stock. In contrast, an ''in-form'' redemption treated as a distribution subject to section 301(c)(2) or (3) refers to a distribution of property to a shareholder in exchange for the corporation's stock.

A. Actual Distributions Subject to Section 301(c)(2) or (3)

Stakeholders asked whether an actual distribution (that is, a distribution that does not involve a redemption in form) to which section 301(c)(2) or (3) applies is subject to the stock repurchase excise tax. Stakeholders contended that the stock repurchase excise tax should not apply to such a distribution, because (i) it is not a section 317(b) redemption, and (ii) it is not economically similar to a section 317(b) redemption (for example, it does not decrease the number of shares outstanding). Instead, such a distribution more closely resembles a dividend, which is excluded from the stock repurchase excise tax (*see* section 4501(e)(6)).

The Treasury Department and the IRS agree that an actual distribution subject to section 301(c)(2) or (3) is not a repurchase (and, therefore, is not subject to the stock repurchase excise tax) because such a distribution is neither a section 317(b) redemption nor economically similar to such a redemption. Accordingly, and consistent with section 3.04(4)(a) of Notice 2023–2 (which does not include such distributions in the list of economically similar transactions), the proposed regulations would provide that an actual distribution subject to section 301(c)(2) or (3) is not subject to the stock repurchase excise tax. *See* proposed § 58.4501–2(e)(5)(iv).

B. Redemptions Treated as Distributions Subject to Section 301(c)(2) or (3)

Stakeholders also asked whether the stock repurchase excise tax applies to an in-form redemption that is treated as a distribution to which section 301(c)(2) or (3) applies. *See* section 302(d). One stakeholder recommended applying the stock repurchase excise tax to a non-pro rata, in-form redemption that is treated as a distribution to which section 301(c)(2) or (3) applies. However, the stakeholder contended that the stock repurchase excise tax should not apply to a pro rata, in-form redemption that is treated as a distribution to which section 301(c)(2) or (3) applies, because such a redemption is more akin to an actual section 301 distribution than a typical section 317(b) redemption. In contrast, another stakeholder recommended that the stock repurchase excise tax should apply to such a transaction because it is a redemption within the meaning of section 317(b) (for example, such a redemption decreases the number of outstanding

shares even though the redemption is pro rata).

The Treasury Department and the IRS agree that an in-form section 317(b) redemption treated as a distribution to which section 301(c)(2) or (3) applies is a repurchase based on the plain language of the statute, regardless of whether the redemption is pro rata. Accordingly, and consistent with section 3.04(3) of Notice 2023–2 (which does not include such transactions in the list of section 317(b) redemptions that are not repurchases), an in-form section 317(b) redemption treated as a distribution to which section 301(c)(2) or (3) applies would be subject to the stock repurchase excise tax under the proposed regulations. *See* proposed § 58.4501–2(e)(3) (providing an exclusive list of section 317(b) redemptions that are not repurchases).

C. Exclusion for Pro Rata Distributions

One stakeholder recommended a general exclusion from the stock repurchase excise tax for distributions made to all shareholders of a covered corporation on a wholly pro rata basis (100 percent pro rata distribution), regardless of whether such distributions involve a redemption in form. According to the stakeholder, such distributions do not implicate most of the policy considerations underlying the tax.

However, the stakeholder noted that adopting this recommendation would require the Treasury Department and the IRS to consider (i) how to determine whether a distribution is 100 percent pro rata if the covered corporation has multiple classes of stock, and (ii) the impact of such distributions on options or convertible debt instruments (to the extent such instruments thereby accrete their proportionate interests in the covered corporation).

The Treasury Department and the IRS disagree with the stakeholder's recommendation. A redemptive 100 percent pro rata distribution is a repurchase because the distribution (i) constitutes a section 317(b) redemption or (ii) is an economically similar transaction. Accordingly, the proposed regulations would not provide an exclusion for 100 percent pro rata distributions, except in the case of pro rata distributions in a complete liquidation to which section 331 or 332 (but not both) applies.

VI. Complete and Partial Liquidations

A. Complete Liquidations

Section 331(a) of the Code provides that amounts received by a shareholder in a distribution in complete liquidation of a corporation are treated as in full payment in exchange for the stock. Section 332 of the Code provides an exception to the general rule in section 331(a). If the requirements of section 332 are met, no gain or loss is recognized upon the receipt by one corporation of property distributed in complete liquidation of another corporation.

Section 332 applies only if the corporation receiving property in the liquidation satisfies the requirements of section 332(b), including the requirement that the corporation own stock in the liquidating corporation meeting the 80-percent voting and value requirements of section 1504(a)(2) of the Code (80-percent distributee). *See* section 332(b)(1).

1. Application of Stock Repurchase Excise Tax

Several stakeholders recommended that a complete liquidation by a covered corporation should not be subject to the stock repurchase excise tax because the complete liquidation terminates the covered corporation's existence. For support, these stakeholders contended that a complete liquidation provides no opportunity for the liquidating corporation to reinvest cash in the corporation's enterprise, which stakeholders stated Congress may have intended to encourage through the enactment of section 4501. In addition, these stakeholders emphasized that a complete liquidation provides no opportunity for a covered corporation to manipulate the corporation's earnings per share (EPS) or other similar metrics, which these stakeholders stated Congress may have intended to discourage through the enactment of section 4501.

As reflected in section 3.04(4)(b)(i)(A) of Notice 2023–2, the Treasury Department and the IRS are of the view that a distribution in complete liquidation of a covered corporation to which either section 331 or 332 (but not both) applies is not a repurchase. Accordingly, the Treasury Department and the IRS are of the view that such distributions should not be subject to the stock repurchase excise tax. *See* proposed § 58.4501–2(e)(5).

2. Determination of Complete Liquidation or Dissolution

Stakeholders also asked whether a distribution is in ''complete liquidation'' of a corporation for purposes of section 331 if some classes of the liquidating corporation's stock do not receive a distribution. Section 331 does not define the term ''complete liquidation.'' Instead, this term is defined in section 346(a) of the Code, which provides that, for purposes of subchapter C of chapter 1, ''a distribution shall be treated as in complete liquidation of a corporation if the distribution is one of a series of distributions *in redemption of all of the stock of the corporation pursuant to a plan*'' (*emphasis added*).

Stakeholders have questioned whether the definition of ''complete liquidation'' in section 346(a) requires a distribution on all classes of stock in order for a dissolution of a corporation to qualify as a distribution in complete liquidation to which section 331 applies. These stakeholders based their question on the language of section 332(b)(2), which provides that a distribution is considered in ''complete liquidation'' within the meaning of section 332 only if ''the distribution is by [the liquidating corporation] in complete cancellation or redemption of all its stock.'' In addition, these stakeholders referenced Treasury regulations and judicial opinions. *See* § 1.332–2(b) (''Section 332 applies only to those cases in which the recipient corporation receives at least partial payment for the stock which it owns in the liquidating corporation.''); *Spaulding Bakeries Inc.* v. *Comm'r,* 252 F.2d 693, 697 (2d Cir. 1958) (emphasizing that ''[s]ection 112(b)(6)(C) [of the Internal Revenue Code of 1939 (the predecessor statute to section 332)] requires for its application a distribution in complete cancellation or redemption of all stock of the dissolved corporation''), *aff'g* 27 T.C. 684 (1957); *H.K. Porter Co.* v. *Comm'r,* 87 T.C. 689 (1986) (agreeing with the rationale of the Second Circuit's decision in *H.K. Porter* and holding that section 332 did not apply to a dissolution because a distribution was made on the dissolving corporation's preferred stock but not its common stock).

As stated previously, the Treasury Department and the IRS are of the view that a distribution in complete liquidation of a covered corporation to which section 331 or 332(a) applies should not be treated as a repurchase. In addition, the Treasury Department and the IRS are of the view that a redemption by a covered corporation pursuant to a corporate dissolution of the covered corporation should not be treated as a repurchase. To clarify the intent of Notice 2023–2, the proposed regulations would provide that a distribution in complete liquidation of a covered corporation to which either section 331 or 332(a) (but not both) applies, a distribution pursuant to a plan of dissolution of a covered

corporation that is reported on the original (but not a supplemented or an amended) IRS Form 966, *Corporate Dissolution or Liquidation* (or any successor form), or a distribution pursuant to a deemed dissolution of the covered corporation (for instance, pursuant to a deemed liquidation under § 301.7701–3), is not a repurchase and, therefore, is not subject to the stock repurchase excise tax. *See* proposed § 58.4501–2(e)(5)(i). For the treatment of liquidations to which both sections 331 and 332 apply, *see* proposed § 58.4501–2(e)(4)(v)(A) and the discussion in part VI.A.3 of this Explanation of Provisions.

3. Liquidations to Which Both Sections 331 and 332 Apply

The rules described in section 3.04(4)(a)(v) of Notice 2023–2 provide that, if sections 331 and 332 both apply to a complete liquidation, then (i) the distribution to the 80-percent distributee is not subject to the stock repurchase excise tax, but (ii) each distribution to which section 331 applies (that is, the surrender of covered corporation stock by each minority shareholder) is subject to the stock repurchase excise tax. The Treasury Department and the IRS have arrived at this view because the 80-percent distributee is the successor to the transferor corporation (that is, the liquidating subsidiary) following the complete liquidation to which section 332 applies. *See* section 381(a)(2). In contrast to the 80-percent distributee, minority shareholders that receive liquidating distributions to which section 331 applies terminate their investment in the transferor corporation's business (that is, are not successors to the transferor corporation).

Moreover, a complete liquidation to which sections 331 and 332 both apply is substantively similar to an upstream reorganization of the liquidating subsidiary into the 80-percent distributee in which the minority shareholders receive only non-qualifying property in exchange for their stock in the liquidating subsidiary. Because such an exchange in an upstream reorganization would constitute a ''repurchase'' under the proposed regulations, the Treasury Department and the IRS are of the view that the same treatment should apply to liquidating distributions to minority shareholders subject to section 331. *See* proposed § 58.4501–2(e)(4)(v)(A).

4. Distributions During Taxable Year of Complete Liquidation or Dissolution

The rule described in section 3.04(4)(b)(i)(B) of Notice 2023–2 provides that, if a covered corporation or a covered surrogate foreign corporation (as appropriate) completely liquidates and dissolves (within the meaning of § 1.331–1(d)(1)(ii)) during a taxable year, no distribution by that corporation during that taxable year is a repurchase. *See also* proposed § 58.4501–2(e)(5)(ii) (incorporating this provision into the proposed regulations). Stakeholders have requested clarification regarding how this provision interacts with the rule described in section 3.04(4)(a)(v) of Notice 2023–2, which (as previously discussed in part VI.A.3 of this Explanation of Provisions) provides that, in a complete liquidation to which sections 331 and 332 both apply, each distribution to which section 331 applies is subject to the stock repurchase excise tax. The proposed regulations would clarify the intent of Notice 2023–2 by providing that the rule in proposed § 58.4501–2(e)(5)(ii) does not apply if the complete liquidation or dissolution is a transaction to which sections 331 and 332 both apply.

B. Partial Liquidations

Section 302(b)(4) of the Code provides that a distribution in redemption of stock held by a shareholder who is not a corporation and in partial liquidation of the distributing corporation receives exchange treatment under section 302(a). For purposes of section 302(b)(4), a distribution will be treated as in partial liquidation of a corporation if the distribution (i) is not essentially equivalent to a dividend (determined at the corporate level rather than at the shareholder level), and (ii) is pursuant to a plan and occurs within the taxable year in which the plan was adopted or within the succeeding taxable year. *See* section 302(e)(1). A partial liquidation may involve a redemption of stock under section 317(b) in which the shareholder actually, in-form surrenders stock of the corporation in exchange for property (redemptive partial liquidation). A partial liquidation also may involve a constructive redemption of stock in which the shareholder is deemed to surrender stock of the corporation in exchange for property, and that deemed surrender satisfies the redemption requirement of sections 302 and 317(b) (constructive partial liquidation). *See* H.R. Conf. Rep. No. 760, 97th Cong., 2nd Sess. 530 (1982) (''Under present law, a distribution in partial liquidation may take place without an actual surrender of stock by the shareholders . . . [and a] constructive redemption of stock is deemed to occur in such transactions. . . . The conferees intend that the treatment of partial liquidations under present law section 346(a)(2) and (b) is to continue for such transactions under new section 302(e).'').

1. Partial Liquidations Involving an Actual Redemption of Stock

Several stakeholders requested guidance on whether a redemptive partial liquidation is treated as a repurchase. One stakeholder recommended that a redemptive partial liquidation by a covered corporation should be subject to the stock repurchase excise tax because a non-pro rata redemptive partial liquidation could achieve consequences similar to those that the stakeholder hypothesized section 4501 was intended to counteract. For example, the stakeholder observed that, if a corporation distributes proceeds from the sale of one of its businesses to its shareholders, the corporation has chosen to make that distribution rather than reinvest the proceeds in its business. Another stakeholder agreed that non-pro rata redemptive partial liquidations should be treated as repurchases but contended that 100-percent pro rata redemptive partial liquidations should not be so treated.

The Treasury Department and the IRS are of the view that redemptive partial liquidations should be treated as repurchases because those transactions qualify as section 317(b) redemptions. Moreover, as discussed in part V.C of this Explanation of Provisions, the Treasury Department and the IRS are of the view that no special exception should be provided for 100-percent pro rata redemptions, particularly because section 4501 does not provide such an exception. In addition, such an exception would complicate the IRS's ability to administer and enforce the stock repurchase excise tax. Accordingly, the proposed regulations would not incorporate these stakeholder recommendations.

2. Partial Liquidations Involving a Constructive Redemption of Stock

Several stakeholders requested guidance on whether a constructive partial liquidation is treated as a repurchase. The stakeholders recommended that constructive partial liquidations should not be treated as repurchases because such transactions neither have the form of an actual redemption nor affect shareholders' proportionate interests. In addition, those stakeholders asserted that the treatment of constructive partial liquidations as constructive redemptions is imputed in revenue rulings to provide beneficial tax treatment to individual shareholders.

The stakeholders further contended that such redemptions are not motivated by, and do not produce, the economic effects that they contend the stock repurchase excise tax was designed to discourage.

The Treasury Department and the IRS decline to adopt the stakeholders' recommendation in the proposed regulations. Section 302(b)(4) applies to a distribution ''in redemption of stock,'' and section 317(b) defines a ''redemption'' for purposes of section 302. Regardless of whether a redemption is constructive rather than actual, the redemption comprises a section 317(b) redemption to which section 302(b)(4) may apply. Therefore, the Treasury Department and the IRS are of the view that a constructive partial liquidation is a repurchase subject to the stock repurchase excise tax, and the proposed regulations would not provide any special exceptions for such transactions.

3. Dividend Exception and Partial Liquidation Look-Through Rule

For a discussion of the dividend exception and the partial liquidation look-through rule in section 302(e)(5), *see* part X.F.3 of this Explanation of Provisions.

VII. Taxable Transactions

A. LBOs and Other Taxable ''Take Private'' Transactions

Under the approach described in Notice 2023–2, unless a statutory exception applies, the target-corporation-funded portion of the consideration in an LBO or other taxable acquisition of the stock of a target corporation would be treated as a repurchase for purposes of computing the target corporation's stock repurchase excise tax base. *See* section 3.09(3) and (4) of Notice 2023–2. This approach tracks longstanding Federal income tax treatment by the IRS of such transactions, particularly that cash received by the minority shareholders in such transactions is subject to the provisions and limitations of section 302. *See,* for example, Rev. Rul. 78–250, 1978–1 C.B. 83 (elimination of minority shareholders' interest in target corporation through the merger of a transitory subsidiary into target corporation treated as a redemption because target corporation was the source of the cash consideration).

Several stakeholders recommended that payments funded (or deemed funded) by the target corporation in a taxable acquisition of target corporation stock should not be treated as a repurchase. Another stakeholder recommended that any redemption that occurs as part of a transaction should be exempt from the definition of ''repurchase'' if, immediately after the transaction, the target corporation's stock no longer is traded on an established securities market. *See* part IV.A of this Explanation of Provisions (discussing the stakeholder's recommendation). Alternatively, the stakeholder recommended that a target corporation's status as a covered corporation be determined at the end of the repurchase transaction. Similarly, another stakeholder recommended that an exemption be created for redemptions undertaken in connection with fully taxable stock dispositions in which target corporation shareholders completely terminate their interest under section 302(b)(3), and as described in *Zenz* v. *Quinlivan,* 213 F.2d 914 (6th Cir. 1954).

According to the stakeholders, deemed redemptions by a target corporation that is a covered corporation in an LBO or other taxable ''take private'' transaction do not implicate their view of the congressional policies underlying the stock repurchase excise tax because the purpose of such a transaction is to cash out completely the target corporation's existing shareholders. For support, these stakeholders highlighted that taxable ''take private'' transactions do not present an opportunity to manipulate EPS or other financial metrics, which (i) become irrelevant after the target corporation ceases to be a publicly traded entity, and (ii) the stakeholders viewed as a practice that Congress intended to discourage through enactment of the stock repurchase excise tax.

Moreover, in the stakeholders' view, imposing the stock repurchase excise tax on a fully taxable stock acquisition based solely on the source of the consideration received by the target corporation's shareholders would create arbitrary distinctions driven by factors that may be commercially focused, such as the target corporation's desired capital structure and its ability to obtain third-party financing. The stakeholders further noted that, if the application of the stock repurchase excise tax to fully taxable stock acquisitions hinges solely on the actual or deemed source of consideration, then parties easily may avoid the tax by borrowing at the acquiring-entity level, buying the target corporation's shares, and then having the target corporation assume or satisfy the debt after the acquisition.

The Treasury Department and the IRS disagree with the stakeholders' recommendations. The treatment of such target corporation-funded payments as a redemption within the meaning of section 317(b) follows longstanding Federal income tax principles and guidance. The Treasury Department and the IRS are of the view that there is no compelling reason to deviate from such long-standing principles and guidance or from the express language of section 4501(c)(1), which defines a repurchase, in part, as ''a redemption within the meaning of section 317(b) with regard to the stock of a covered corporation.'' The Treasury Department and the IRS are of the view that integrating long-standing Federal income tax principles and guidance into the proposed regulations would facilitate taxpayer compliance, as well as the ability of the IRS to administer and enforce the stock repurchase excise tax. Accordingly, the proposed regulations would not adopt the stakeholders' recommendations regarding taxable stock acquisitions.

Several stakeholders offered alternative recommendations in the event the proposed regulations do not exclude taxable stock acquisitions from the stock repurchase excise tax. One stakeholder agreed with the approach described in Notice 2023–2, under which a taxable stock acquisition is treated as a section 317(b) redemption only to the extent of the consideration sourced from the target corporation. The stakeholder recommended that, for purposes of the stock repurchase excise tax, sourcing should be guided by the same principles that apply to determine the identity of the borrower for Federal income tax purposes. The proposed regulations would retain the approach described in Notice 2023–2.

Another stakeholder recommended that issuances by the target corporation in the same taxable year as the ''take private'' transaction, including issuances that occur after the ''take private'' transaction, should be taken into account for purposes of the netting rule. The Treasury Department and the IRS disagree with this recommendation. As previously discussed, the Treasury Department and the IRS are of the view that, to be consistent with the statutory language in section 4501, stock issued by a corporation after it ceases to be a covered corporation should not be taken into account under the netting rule. *See* part IV.A of this Explanation of Provisions. Accordingly, the proposed regulations would take into account stock issued by the target corporation in the same taxable year as the ''take private'' transaction only if that stock was issued during the period in which the target corporation was a covered corporation, as determined under these

proposed regulations. *See* proposed §§ 58.4501–2(d)(1) and 58.4501–4(b)(2).

B. Section 304 Transactions

1. Section 304(a)(1) Transactions

Section 304(a)(1) of the Code applies if one corporation purchases stock of another corporation from a shareholder or shareholders in control of both corporations in exchange for cash or other property (section 304(a)(1) transaction). If section 304(a)(1) applies, the cash or other property paid to the controlling shareholder or shareholders is treated as a distribution in redemption of the stock of the acquiring corporation. To the extent that the distribution is treated as a distribution to which section 301 applies, (i) the selling shareholder or shareholders are treated in the same manner as if they had transferred the acquired stock to the acquiring corporation in a transaction to which section 351(a) of the Code applies, and then (ii) the acquiring corporation is treated in the same manner as if it had redeemed the stock it was treated as issuing in the transaction.

The approach described in sections 3.04(3)(a) and 3.08(4)(e) of Notice 2023–2, respectively, provides that a deemed redemption resulting from the application of section 304(a)(1) is neither a repurchase nor an issuance for purposes of the stock repurchase excise tax. Stakeholders generally agreed with this approach, for several reasons.

First, stakeholders noted that section 304(a)(1) transactions involve no actual contraction in the number of shares of acquiring corporation stock. Second, stakeholders observed that, to the extent the deemed redemption is treated as a distribution to which section 301 applies, the section 304(a)(1) transaction would consist of an offsetting issuance and repurchase of acquiring corporation stock. However, those stakeholders correctly noted that the deemed redemption would be statutorily excluded from the computation of the acquiring corporation's stock repurchase excise tax base under section 4501(e)(6) to the extent that the deemed redemption is treated as a dividend under section 301(c)(1). As a result, the Federal income tax treatment mandated by section 304(a)(1), combined with the statutory exclusion for dividends under section 4501(e)(6), would manufacture an automatic net issuance.

Finally, one stakeholder claimed that it could be difficult for taxpayers to determine whether section 304(a)(1) applies to public company M&A transactions because publicly traded corporations do not know the identity of their shareholders. For that reason, the stakeholder also contended that it could be difficult for the IRS to administer and enforce the stock repurchase excise tax with respect to section 304(a)(1) transactions.

However, several stakeholders expressed concern that an exemption for all section 304(a)(1) transactions may exclude transactions that (i) satisfy the statutory requirements for section 304 qualification, and (ii) are economically similar to a conventional stock repurchase. As an illustration, the stakeholders presented the following fact pattern. Individual A owns 50 percent of the stock of two public corporations. Individual A sells a portion of its stock in one corporation (that is, the target corporation) to the other corporation (that is, the acquiring corporation). The stakeholders explained that section 304(a)(1) would apply to the sale, but individual A may qualify for sale or exchange treatment under section 302(a) depending on individual A's actual and constructive ownership of the target corporation following the transaction. According to the stakeholder, applying the stock repurchase excise tax may be appropriate in this situation and in other situations in which control of the target and acquiring corporations is not widely dispersed and both corporations remain publicly traded after the transaction.

The Treasury Department and the IRS are of the view that the complexity of regulations applying the stock repurchase excise tax with regard to section 304(a)(1) transactions would outweigh significantly any benefit of applying this tax to those transactions. In addition, the Treasury Department and the IRS are of the view that applying the stock repurchase excise tax to section 304(a)(1) transactions would create significant difficulty for the IRS to administer and enforce the tax, as well as for taxpayers to calculate and report their tax with certainty. Accordingly, the Treasury Department and the IRS are of the view that the stock repurchase excise tax should not apply to a redemption that is deemed to occur by virtue of section 304(a)(1). *See* proposed §§ 58.4501–2(e)(3)(i) and 58.4501–4(f)(4).

2. Section 304(a)(2) Transactions

Section 304(a)(2) applies if one corporation (that is, the acquiring corporation) purchases stock of another corporation (that is, the target corporation) from a shareholder of the target corporation in exchange for cash or other property and that target corporation controls the acquiring corporation (section 304(a)(2) transaction). If section 304(a)(2) applies, that property is treated as a distribution in redemption of the stock of the target corporation. The approach described in Notice 2023–2 does not exempt section 304(a)(2) transactions from the application of the stock repurchase excise tax. *See generally* section 3.04(3) of Notice 2023–2 (excepting solely section 304(a)(1) transactions).

One stakeholder noted that the application of the stock repurchase excise tax to section 304(a)(2) transactions generally is clear and is analogous to the rule treating an acquisition of stock of a covered corporation by a specified affiliate as a repurchase to which the stock repurchase excise tax applies. The Treasury Department and the IRS agree with the stakeholder. Accordingly, the proposed regulations would not exempt section 304(a)(2) transactions from the application of the stock repurchase excise tax.

VIII. Reorganizations

A. Acquisitive Reorganizations

1. Overview

The approach described in Notice 2023–2 treats an exchange of target corporation stock by the target corporation's shareholders in an acquisitive reorganization as an economically similar transaction. *See* section 3.04(4)(a)(i) of Notice 2023–2. The notice defines an ''acquisitive reorganization'' as a transaction that qualifies as a reorganization under section 368(a)(1)(A) of the Code (including by reason of section 368(a)(2)(D) or (E)), section 368(a)(1)(C), or section 368(a)(1)(D) (D reorganization) (if the reorganization satisfies the requirements of section 354(b)(1) of the Code). *See* section 3.02(1) of Notice 2023–2.

Under the approach described in Notice 2023–2, the effect of an acquisitive reorganization on a target corporation's stock repurchase excise tax base is computed by first including in that tax base the fair market value of *all* target corporation stock exchanged in the transaction, regardless of the type of consideration for which the stock is exchanged. The stock repurchase excise tax base then is reduced under the statutory exception in section 4501(e)(1) (reorganization exception) by the fair market value of the target corporation stock exchanged for property permitted to be received by the target corporation shareholders without recognition of gain or loss under section 354 (that is, qualifying property). Thus, under the approach described in Notice 2023–2,

the target corporation generally is subject to the stock repurchase excise tax only to the extent of the fair market value of target corporation stock exchanged for property that is non-qualifying property.

For purposes of this preamble, the term ''acquisitive reorganization'' includes each transaction described as an acquisitive reorganization in Notice 2023–2 as well as a transaction that qualifies as a reorganization under section 368(a)(1)(G) (if the reorganization satisfies the requirements of section 354(b)(1)).

Under Federal income tax principles, acquisitive reorganizations involve the following two elements. First, the target corporation transfers all or a portion of its assets to the acquiring corporation in exchange for consideration from the acquiring corporation. Second, the target corporation distributes the consideration received from the acquiring corporation to the target corporation's shareholders in exchange for their target corporation stock in an actual or deemed liquidation of the target corporation (target redemptive distribution). *See,* for example, section 361(a) and (c) of the Code (providing for nonrecognition of gain or loss for the target corporation's transfer of assets in exchange for stock or securities of a party to the reorganization and the target corporation's distribution of that stock or securities pursuant to a plan of reorganization); section 368(a)(1)(C) and (a)(2)(G) (to similar effect).

2. Feedback Received

a. In General

Several stakeholders recommended that acquisitive reorganizations should not be subject to the stock repurchase excise tax, to any extent. These stakeholders contended that, although a target redemptive distribution in an acquisitive reorganization resembles a section 317(b) redemption, such a transaction should not be subject to the stock repurchase excise tax even if non-qualifying property is provided. *See* parts VIII.A.2.b and c of this Explanation of Provisions.

b. Stakeholders Contend Acquisitive Reorganizations Are Not Economically Similar Transactions

Some stakeholders asserted that acquisitive reorganizations are economically distinguishable from a section 317(b) redemption and therefore should not be treated as economically similar transactions. According to these stakeholders, the basic economic nature of an acquisitive reorganization (at least in situations in which the parties to the transaction are unrelated) is a two-company acquisitive transaction in which the target corporation shareholders sell the target corporation to the acquiring corporation. In contrast, a section 317(b) redemption is a transaction in which a single corporation acquires its own stock from its shareholders.

Several stakeholders stated that an acquisitive reorganization between unrelated parties is motivated primarily by bona fide investment and strategic business purposes and does not give rise to any abuse that the stakeholders hypothesized Congress may have intended to discourage through enactment of the stock repurchase excise tax. These stakeholders acknowledged that the exchange of target corporation stock for non-qualifying property in a target redemptive distribution either constitutes or resembles a section 317(b) redemption. However, the stakeholders questioned whether this exchange under Federal income tax principles provides an adequate basis for designating the transaction as ''economically similar.'' The stakeholders further questioned why a distribution in complete liquidation as part of a reorganization (that is, the target redemptive distribution) should give rise to an economically similar transaction under the approach described in Notice 2023–2 even though a distribution in complete liquidation subject to either section 331 or 332 (but not both) would not.

With regard to the latter point, several stakeholders noted that the exchange between the target corporation and its shareholders in a forward merger that failed to qualify as a reorganization would not be subject to the stock repurchase excise tax. *See* Rev. Rul. 69–6, 1969–1 C.B. 104 (treating such an exchange as a distribution in complete liquidation to which section 331 applies). One stakeholder suggested that the application of this tax should be based upon the substantive Federal income tax characterization of the steps of the transaction, rather than upon the overall Federal income tax characterization of the transaction as a reorganization. For support, the stakeholder contended that their recommendation would mitigate the potential for a more onerous result under the stock repurchase excise tax if the components of such a transaction qualify for reorganization treatment.

Several stakeholders also recommended that transactions that qualify as a reorganization described in either section 368(a)(1)(B) (B reorganization) or 368(a)(1)(A) by reason of section 368(a)(2)(E) (reverse triangular merger) should not be subject to the stock repurchase excise tax. The stakeholders contended that those types of reorganizations should not be subject to the stock repurchase excise tax based on their view that such transactions, both in substance and in form, involve an acquisition of stock by a third party rather than a repurchase or redemption of target corporation stock.

c. Effect of the Statutory Exception in Section 4501(e)(1)

Stakeholders acknowledged that the inclusion of the statutory exception in section 4501(e)(1) (that is, the reorganization exception) is subject to several interpretations. Several stakeholders acknowledged that the inclusion of this exception in section 4501 could be construed as reflecting congressional intent that all stock exchanged for non-qualifying property in a reorganization should be treated as economically similar to a section 317(b) redemption. However, the stakeholders recommended that the Treasury Department and the IRS not adopt that interpretation.

In contrast, one stakeholder contended that the inclusion of the reorganization exception does not necessarily indicate that Congress intended all non-qualifying property received in any acquisitive reorganization to be subject to the stock repurchase excise tax. Rather, the stakeholder asserted that the application of this statutory exception requires (i) identifying a transaction as a section 317(b) redemption or an economically similar transaction that occurs as part of a reorganization, (ii) applying this statutory exception to exempt the target corporation stock exchanged for qualifying property, and then (iii) subjecting the target corporation stock exchanged for non-qualifying property to the stock repurchase excise tax to the extent gain or loss is recognized. Similarly, several stakeholders contended that the reorganization exception could be given effect by applying this exception only to reorganizations that most closely resemble section 317(b) redemptions, such as split-offs (as defined in part IX of this Explanation of Provisions) with non-qualifying property, or E reorganizations involving an exchange of the recapitalizing corporation's stock for newly issued stock and non-qualifying property.

d. Response to Stakeholder Feedback

The Treasury Department and the IRS are of the view that the recommendations of the stakeholders

would be contrary to the statutory language of section 4501. The reorganization exception provides that section 4501(a) does not apply ''to the extent that the repurchase is part of a reorganization (within the meaning of section 368(a)) and no gain or loss is recognized on such repurchase by the shareholder under chapter 1 by reason of such reorganization.'' Section 4501(e)(1). The Treasury Department and the IRS are of the view that the presence of the reorganization exception in section 4501(e)(1) indicates that exchanges of target corporation stock occurring as part of an acquisitive reorganization are subject to the stock repurchase excise tax. Indeed, this statutory exception would have no effect if the exchange of target corporation stock for non-qualifying property in reorganizations were exempt from the stock repurchase excise tax. Moreover, the Treasury Department and the IRS are of the view that the proposed regulations should not reduce the statutorily mandated scope of the reorganization exception, but rather should give full effect to its language mandating that the reorganization exception applies to all reorganizations ''within the meaning of section 368(a).''

The Treasury Department and the IRS also are of the view that implementation of the reorganization exception by reliance on sections 354 and 356 of the Code would provide bright-line rules that taxpayers could apply and the IRS could administer and enforce with certainty. Specifically, every acquisitive reorganization involves a target redemptive distribution to a target corporation shareholder to which section 354 or 356 is applied.

Accordingly, the proposed regulations would treat acquisitive reorganizations as economically similar transactions. *See* proposed § 58.4501–2(e)(4)(i); *see also* proposed § 58.4501–3(c) (reorganization exception); part X.A of this Explanation of Provisions (discussion of reorganization exception). However, the proposed regulations would not subject B reorganizations to the stock repurchase excise tax. *See* proposed §§ 58.4501–1(b)(1) and 58.4501–2(e)(4)(i).

Lastly, the Treasury Department and the IRS view the distinction between taxable forward mergers and forward mergers qualifying as reorganizations as appropriate because there is a successor to the target corporation in an acquisitive asset reorganization (*see* section 381(a)). In contrast, the target corporation in a complete liquidation subject to section 331 ceases to exist for Federal income tax purposes.

B. Sourcing Approach to Acquisitive Reorganizations

Several stakeholders recommended that, if the proposed regulations do not wholly exempt acquisitive reorganizations from the stock repurchase excise tax, this tax should apply to acquisitive transactions solely to the extent that any non-qualifying property is sourced from the target corporation (sourcing approach). According to the stakeholders, to the extent that the consideration used to repurchase target corporation stock is attributable to the acquiring corporation or another third party, the transaction does not represent the target corporation's redemption of its own stock and therefore should not be subject to the stock repurchase excise tax.

However, another stakeholder contended that the approach in Notice 2023–2 arguably facilitates the administration of the stock repurchase excise tax by treating all exchanges of target corporation stock in a reorganization as a repurchase, irrespective of the type of reorganization, and regardless of the source of consideration. Nonetheless, for the reasons previously discussed in this part VIII.B, the stakeholder contended that a sourcing approach strikes a better balance with the statutory language and with the stakeholder's opinion that Congress enacted the stock repurchase excise tax to curtail single-entity corporate contractions.

Another stakeholder acknowledged that a sourcing approach could raise issues of administrability, particularly due to the fungible nature of cash and the fact that the operations of the target corporation and the acquiring corporation often are integrated following an acquisition. The stakeholder noted that these difficulties arguably would be compounded in situations in which a target operating corporation is merged directly into an acquiring operating corporation, although other forms of post-merger integration could present similar challenges.

Notwithstanding these administrative difficulties, these stakeholders contended that a sourcing approach could be administered effectively. One stakeholder stated that the challenges presented by a sourcing approach are not meaningfully different from other issues that have been addressed by longstanding authorities concerning reorganizations. For instance, a sourcing approach is used to determine whether funds distributed to the target corporation's shareholders prior to a B reorganization are properly treated as non-qualifying property. *See,* for example, Rev. Rul. 70–172, 1970–1 C.B. 77 (dividend distribution of property sourced from the target corporation treated as separate and distinct from an immediately subsequent B reorganization). With regard to reverse triangular mergers, these stakeholders noted that funds sourced from the target corporation are taken into account for purposes of the ''substantially all'' test in section 368(a)(2)(E)(i), but not for purposes of measuring the acquisition of ''control'' under section 368(a)(2)(E)(ii). *See* § 1.368–2(j)(3)(i) and (iii).

The stakeholders also questioned the different treatment under Notice 2023–2 of acquisitive reorganizations and taxable stock acquisitions. These stakeholders observed that, under Notice 2023–2, the stock repurchase excise tax would apply to all consideration consisting of non-qualifying property in an acquisitive reorganization. In contrast, the rules described in Notice 2023–2 provides that the stock repurchase excise tax is imposed in a taxable stock acquisition only to the extent of the consideration sourced from the target corporation. In the stakeholders' view, this inconsistent treatment is difficult to justify as a policy matter because taxable and tax-free transactions may be economically similar.

The Treasury Department and the IRS are of the view that the stakeholders' recommendation is not supported by the statutory language of the reorganization exception. The plain language of the reorganization exception contains no reference to the source of the consideration for which the target corporation shareholders exchange their stock in a target redemptive distribution. Instead, the application of the reorganization exception to a target redemptive distribution in an acquisitive reorganization depends only on whether ''gain or loss is recognized on such repurchase by the shareholder under chapter 1 by reason of such reorganization.'' In other words, under the reorganization exception, the source of the consideration for which the target corporation shareholders exchange their stock in a target redemptive distribution is irrelevant in determining the application of the stock repurchase excise tax to acquisitive reorganizations. Lastly, the Treasury Department and the IRS are of the view that an extra-statutory sourcing rule recommended by the stakeholders would be neither necessary nor appropriate to carry out the purposes of the stock repurchase excise tax.

For the foregoing reasons, the proposed regulations would not incorporate a sourcing approach to determine the application of the stock repurchase excise tax to acquisitive reorganizations. Rather, under the proposed regulations, the stock repurchase excise tax would apply to a repurchase that is part of a reorganization to the extent a shareholder exchanges their stock for non-qualifying property.

C. Commissioner v. Clark

One stakeholder recommended that the stock repurchase excise tax should not apply to any hypothetical deemed issuance and redemption under *Clark* v. *Commissioner,* 489 U.S. 726 (1989), because such a transaction either (i) is a fictional transaction that is not within the scope of the tax, or (ii) results in a net zero adjustment pursuant to the netting rule in the case of domestic covered corporations. Another stakeholder also noted that the deemed issuance under *Clark* would offset the deemed redemption.

The Treasury Department and the IRS are of the view that *Clark* should not apply in determining the applicability of the stock repurchase excise tax to non-qualifying property furnished in a reorganization, other than to determine the applicability of the dividend exception (*see* the discussion in part VIII.F of this Explanation of Provisions). This view was incorporated into Notice 2023–2, and the proposed regulations likewise would not provide any special rules based on an analogical application of *Clark.*

D. E Reorganizations

1. Treatment of E Reorganizations Under Notice 2023–2

Under the approach described in Notice 2023–2, E reorganizations are treated as economically similar transactions in the same manner as other reorganizations for purposes of the stock repurchase excise tax. Accordingly, a recapitalizing corporation has a repurchase to the extent of the fair market value of the shares exchanged by its shareholders in the transaction. *See* section 3.04(4)(a)(ii) of Notice 2023–2. However, the fair market value of the repurchased shares that are exchanged for qualifying property reduces the corporation's stock repurchase excise tax base. *See* section 3.07(2)(b) of Notice 2023–2 (applying the statutory exception in section 4501(e)(1) to E reorganizations). As a result, the recapitalizing corporation is subject to the stock repurchase excise tax only to the extent of the fair market value of its shares that are repurchased with non-qualifying property (if any).

Additionally, the stock issued by the recapitalizing corporation in the transaction is disregarded for purposes of the netting rule under the ''no double benefit rule.'' *See* section 3.08(4)(d) of Notice 2023–2; *see also* part XI.C.2 of this Explanation of Provisions for a discussion of the no double benefit rule.

2. Feedback Received

Several stakeholders recommended that an exchange of stock for qualifying property in an E reorganization should not be subject to the stock repurchase excise tax. However, the stakeholders recommended that shares that are repurchased with non-qualifying property in an E reorganization should be subject to the stock repurchase excise tax because the exchange is substantially similar to the redemption of stock for cash, unless the receipt of non-qualifying property is treated as a separate transaction under § 1.301–1(j).

3. Exchange of Stock for Qualifying Property in an E Reorganization

The Treasury Department and the IRS disagree with the stakeholders' recommendation that an exchange of stock for qualifying property in an E reorganization should not be included in the recapitalizing corporation's stock repurchase excise tax base. As discussed in part VIII.A.2.d of this Explanation of Provisions, the Treasury Department and the IRS are of the view that the reorganization exception would be most appropriately implemented by (i) treating all exchanges of stock between a corporation and its shareholders occurring as part of a reorganization as an economically similar transaction, and then (ii) removing from the corporation's stock repurchase excise tax base the amount of target corporation stock for which the target corporation shareholders receive qualifying property. The Treasury Department and the IRS also are of the view that adopting uniform treatment for reorganizations would implement the reorganization exception in a manner most consistent with its statutory language (as set forth in section 4501(e)(1)). Lastly, the Treasury Department and the IRS are of the view that this approach would facilitate the IRS's ability to administer and enforce the stock repurchase excise tax and enable taxpayers to apply the tax with greater certainty.

Accordingly, the proposed regulations would include the stock-for-qualifying property portion of an exchange occurring as part of an E reorganization in the stock repurchase excise tax base, and then exclude that portion in a later step of the stock repurchase excise tax base computation. *See* proposed §§ 58.4501–2(e)(4)(ii) and 58.4501–3(c). The Treasury Department and the IRS request comments on the proposed treatment of E reorganizations.

E. F Reorganizations

1. Treatment of F Reorganizations Under Notice 2023–2

Under the approach described in Notice 2023–2, F reorganizations are treated as economically similar transactions in the same manner as other reorganizations for purposes of the stock repurchase excise tax. Accordingly, the transferor corporation has a repurchase to the extent of the fair market value of the shares exchanged by its shareholders in the transaction. *See* section 3.04(4)(a)(iii) of Notice 2023–2. However, the fair market value of the repurchased shares that are exchanged for qualifying property reduces the corporation's stock repurchase excise tax base. *See* section 3.07(2)(c) of Notice 2023–2 (applying the statutory exception in section 4501(e)(1) to F reorganizations). As a result, the transferor corporation is subject to the stock repurchase excise tax only to the extent of the fair market value of its shares that are repurchased with non-qualifying property (if any).

A distribution of non-qualifying property by the transferor corporation in an F reorganization is treated as a separate transaction (for example, under section 302). *See* § 1.368–2(m)(1)(iii) (providing that any distribution of money or other property from either the transferor corporation or the resulting corporation, including any money or other property exchanged for shares, in an F reorganization is treated as an unrelated, separate transaction from the reorganization).

2. Feedback Received

Several stakeholders recommended that F reorganizations should not be subject to the stock repurchase excise tax because the stock issued in an F reorganization does not qualify as ''property'' within the meaning of section 317(a). These stakeholders contended that no ''redemption'' could occur within the meaning of section 317(b), and therefore the stock repurchase excise tax should not apply.

For the same rationale as other reorganizations, the Treasury Department and the IRS continue to be of the view that F reorganizations should be treated as economically similar transactions for purposes of the stock repurchase excise tax. *See* parts

VIII.A and D of this Explanation of Provisions (discussing acquisitive reorganizations and E reorganizations). Moreover, the Treasury Department and the IRS are of the view that adopting uniform treatment for reorganizations would reduce complexity for taxpayers and facilitate the IRS's ability to administer and enforce the stock repurchase excise tax. The proposed regulations reflect this view. *See* proposed §§ 58.4501–2(e)(4)(iii) and 58.4501–3(c). The Treasury Department and the IRS request comments on the proposed treatment of F reorganizations.

F. Downstream Reorganizations and Other Related-Party Reorganizations

Several stakeholders recommended that, if reorganizations generally are not subject to the stock repurchase excise tax under the proposed regulations, related-party reorganizations (such as an acquisition of a publicly traded parent corporation's stock by a specified affiliate, or a reorganization between two covered corporations under common control) nonetheless should be subject to the stock repurchase excise tax to the extent of the non-qualifying property received by shareholders. One stakeholder suggested that the receipt of non-qualifying property in such transactions is economically identical to a conventional stock repurchase.

The Treasury Department and the IRS agree with stakeholders that such transactions should be subject to the stock repurchase excise tax. However, because reorganizations generally would be subject to the stock repurchase excise tax under the proposed regulations, no special rules are needed to address related-party reorganizations. Accordingly, the proposed regulations would not adopt the stakeholders' recommendation.

G. Reverse Acquisitions Involving Investment Companies

One stakeholder suggested that, if the proposed regulations generally do not apply the stock repurchase excise tax to acquisitive reorganizations, the proposed regulations should apply this tax to certain reverse acquisitions involving a publicly traded acquiring corporation. According to the stakeholder, if the historical business of a publicly traded acquiring corporation has declined in value to the point that the corporation's stock is trading based on the net value of its cash and other investment assets, and if the target corporation shareholders as a group will obtain more than 50 percent of the fair market value of the acquiring corporation's stock in an acquisitive reorganization, then any non-qualifying property received by the target corporation shareholders in the reorganization may resemble a repurchase. Although the stakeholder noted that such transactions are rare, the stakeholder recommended that the Treasury Department and the IRS consider designating such transactions as economically similar.

The Treasury Department and the IRS are of the view that no special rules are required to address these types of transactions because the proposed regulations would not exclude acquisitive reorganizations from the stock repurchase excise tax. Accordingly, the proposed regulations do not incorporate the stakeholder's suggested provision.

IX. Section 355 Transactions

Under the approach described in Notice 2023–2, a section 355 transaction in which a distributing corporation (within the meaning of section 355(a)(1)(A) of the Code) distributes stock of a controlled corporation (within the meaning of section 355(a)(1)(A)) and, if applicable, other property or money to the distributing corporation's shareholders in exchange for a portion of the shareholders' stock in the distributing corporation (split-off) is treated as an economically similar transaction. Accordingly, the distributing corporation has made a repurchase to the extent of the fair market value of the distributing corporation shares exchanged by its shareholders in the transaction. *See* section 3.04(4)(a)(iv) of Notice 2023–2.

However, the fair market value of the repurchased shares that are exchanged for qualifying property reduces the distributing corporation's stock repurchase excise tax base, regardless of whether the distribution was carried out as part of a D reorganization. *See* section 3.07(2) of Notice 2023–2. As a result, the distributing corporation is subject to the stock repurchase excise tax only to the extent of the fair market value of its shares that are repurchased with non-qualifying property (if any). A distribution by a distributing corporation of stock of a controlled corporation qualifying under section 355 that is not a split-off is not a repurchase subject to the stock repurchase excise tax. *See* section 3.04(4)(b)(ii) of Notice 2023–2.

A. In General

Several stakeholders recommended that a spin-off (that is, a distribution of stock of a controlled corporation (Controlled) by the distributing corporation (Distributing) to Distributing's shareholders) to which section 355 applies should not be treated as a repurchase because spin-offs do not involve an exchange of Controlled stock for Distributing stock. The stakeholders also recommended that a split-up (that is, a liquidating distribution in which Distributing distributes the stock of more than one Controlled) or split-off to which section 355 applies, and in which only Controlled stock (and no non-qualifying property) is distributed, should not be treated as a repurchase. For example, one stakeholder found it significant that a split-off without non-qualifying property generally would not reduce the number of shares outstanding or enhance the EPS of Distributing.

In contrast, stakeholders recommended that any non-qualifying property distributed in a split-off to which section 355 applies should be treated as a repurchase to the same extent as if that non-qualifying property were distributed in a redemption under section 302(a), because the source of the cash and the form of the transaction frequently are the same as in a conventional stock buyback. One stakeholder also recommended treating a split-up with non-qualifying property as a repurchase in the same manner.

The Treasury Department and the IRS are of the view that spin-offs and split-ups should not be subject to the stock repurchase excise tax. *See* proposed § 58.4501–2(e)(5)(iii)(A). With regard to a spin-off, the Treasury Department and the IRS are of this view because Distributing does not provide consideration to Distributing's shareholders in exchange for their Distributing stock (that is, no repurchase could be treated as having occurred). With regard to a split-up, the Treasury Department and the IRS are of this view because Distributing completely liquidates as a result of Distributing's distribution of consideration to its shareholders in exchange for their Distributing stock. The proposed treatment of spin-offs and split-ups is consistent with the proposed treatment of non-redemptive distributions under section 301 and distributions in complete liquidation, which are analogous to spin-offs and split-ups, respectively. *Cf.* proposed §§ 58.4501–2(e)(5)(iv) (exempting certain non-redemptive distributions under section 301 from the stock repurchase excise tax); 58.4501–2(e)(5)(i) (exempting distributions in complete liquidation that are exclusively under section 331 or 332 from the stock repurchase excise tax).

However, the proposed regulations would clarify that a distribution by Distributing of non-qualifying property

in exchange for Distributing stock in pursuance of a spin-off or a split-up would be a repurchase. *See* proposed § 58.4501–2(e)(5)(iii)(B).

The Treasury Department and the IRS also continue to be of the view that split-offs should be subject to the stock repurchase excise tax. *See* proposed § 58.4501–2(e)(4)(iv). Accordingly, Distributing would have a repurchase to the extent of the fair market value of the Distributing stock exchanged by Distributing's shareholders in the transaction. However, the fair market value of the repurchased Distributing stock that is exchanged for qualifying property would be subject to the reorganization exception, regardless of whether the split-off occurred as part of a D reorganization. *See* proposed § 58.4501–3(c). As a result, Distributing would be subject to the stock repurchase excise tax only to the extent of the fair market value of its stock that is repurchased with non-qualifying property (if any).

B. Exchange of Controlled Securities in a Split-Off to Which Section 355 Applies

Notice 2023–2 does not explicitly address whether a distribution by Distributing of Controlled securities to Distributing shareholders in exchange for their Distributing stock in a split-off is treated as a repurchase. However, Controlled securities that are exchanged for Distributing stock would not constitute qualifying property under the rules described in Notice 2023–2. As a result, the exchange of Controlled securities for Distributing stock in a split-off would be subject to the stock repurchase excise tax under the rules described in Notice 2023–2.

A stakeholder recommended that, to the extent the Treasury Department and the IRS view a distribution of Controlled securities as a substitute for cash, the distribution of Controlled securities in exchange for Distributing stock in a split-off to which section 355 applies should be treated as a repurchase.

The Treasury Department and the IRS continue to be of the view that Controlled securities that are exchanged for Distributing stock should not constitute qualifying property for purposes of the stock repurchase excise tax. The Treasury Department and the IRS have reached this position based on the rationale that, unlike an exchange of Distributing stock for Controlled stock, an exchange of Distributing stock for Controlled securities generally would achieve an outcome more analogous to an exchange of Distributing stock for non-qualifying property. Accordingly, the Treasury Department and the IRS are of the view that no special rules are needed to address this issue.

C. Clarification of Examples 13 and 14 in Notice 2023–2

Section 3.09 of Notice 2023–2 contains *Examples 13* and *14.* These examples are based on *Example 11* of Notice 2023–2, in which Distributing distributes Controlled stock and cash to Distributing's shareholders in exchange for their Distributing stock. The facts in *Example 13* are the same as in *Example 11,* except that *Example 13* provides that ''Distributing distributes the Controlled stock to its shareholders pro rata without the shareholders exchanging any Distributing stock (Spin-Off).'' The facts in *Example 14* are the same as in *Example 13,* except that the ''Spin-Off is carried out as part of a transaction qualifying as a D reorganization.''

A stakeholder recommended that the proposed regulations incorporate revisions to *Examples 13* and *14* to clarify whether the cash distribution described in those examples constitutes a distribution in exchange for Distributing stock. The stakeholder interpreted *Examples 13* and *14* to provide clearly that no Distributing stock is surrendered by Distributing's shareholders in the ''Spin-Off'' in both examples, but nonetheless questioned whether any Distributing stock could have been surrendered for the cash distributed by Distributing with the Controlled stock. Therefore, the stakeholder recommended that *Examples 13* and *14* explicitly state whether or not Distributing stock is surrendered in exchange for the cash distributed as well as the stock distributed.

The Treasury Department and the IRS have revised *Example 13* to explicitly state that no stock of Distributing is exchanged in the ''Spin-Off'' for distributed cash or distributed Controlled stock. This clarification would confirm the interpretation of stakeholders and the intent of the Treasury Department and the IRS. *See* proposed § 58.4501–5(b)(13).

Additionally, the Treasury Department and the IRS have modified the facts of *Example 14* to clarify the treatment of an exchange of Distributing stock for non-qualifying property in pursuance of a spin-off. *See* proposed § 58.4501–5(b)(14). For the treatment of the exchange of Distributing stock in pursuance of a spin-off, *see* proposed § 58.4501–2(e)(5)(iii)(B) and the discussion in part IX.A of this Explanation of Provisions.

X. Statutory Exceptions

A. Repurchase as Part of a Reorganization

1. In General

Section 4501(e)(1) provides an exception (that is, the reorganization exception) to the application of the stock repurchase excise tax ''to the extent that the repurchase is part of a reorganization (within the meaning of section 368(a)) and no gain or loss is recognized on such repurchase by the shareholder . . . by reason of such reorganization.'' To facilitate the IRS's ability to administer and enforce the stock repurchase excise tax, and to enable taxpayers to apply the tax with greater certainty, Notice 2023–2 adopts a consideration-based approach to the reorganization exception. As described in section 3.07(2) of Notice 2023–2, the fair market value of stock repurchased by a covered corporation in transactions listed in that section is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base, to the extent that the repurchase is in exchange for property permitted by section 354 or 355 to be received without the recognition of gain or loss (that is, qualifying property). These transactions consist of a repurchase by: (i) a target corporation as part of an acquisitive reorganization; (ii) a recapitalizing corporation as part of an E reorganization; (iii) a transferor corporation as part of an F reorganization; and (iv) a distributing corporation as part of a split-off (whether or not part of a D reorganization).

Stakeholders have suggested three general approaches to implement the reorganization exception. Under the stakeholders' first approach, the reorganization exception would apply only if no gain or loss is recognized by a shareholder on a repurchase that occurs as part of a reorganization under section 368(a). As a result, if a shareholder receives both qualifying property and non-qualifying property in an actual or deemed redemption that occurs as part of a reorganization, the reorganization exception would not apply to *any* of the consideration received if the shareholder recognized *any* built-in gain or loss in the target corporation stock exchanged for that consideration.

Under the stakeholders' second approach, the reorganization exception would exclude an actual or deemed redemption that occurs as part of a reorganization under section 368(a) *to the extent* a shareholder does not recognize gain or loss. At least one

stakeholder recommended this approach because the stakeholder found it significant that a target corporation shareholder's non-taxable receipt of acquiring corporation stock (that is, qualifying property) does not result in the termination or ''cashing out'' of the target corporation shareholder's proprietary interest in the target corporation.

Another stakeholder provided a variation to this second approach that would incorporate a rebuttable presumption. Under this variation, the reorganization exception would apply to a repurchase solely to the extent that stock of the target corporation is exchanged by target corporation shareholders for qualifying property. In other words, all shareholders of the target corporation that receive non-qualifying property in exchange for target corporation stock would be presumed to recognize gain or loss to the full extent of the non-qualifying property received. The stakeholder recommended allowing a target corporation to rebut this presumption to the extent the target corporation could demonstrate that its shareholders did not recognize gain or loss in the reorganization. However, the stakeholder found it questionable as a policy matter that, under this variation of the second approach, a target corporation that provides solely non-qualifying property to the target corporation shareholders in exchange for target corporation stock would not be treated as repurchasing the target corporation shareholders' stock if the target corporation rebuts the presumption of gain or loss recognition.

Under the stakeholders' third approach, the reorganization exception would apply to a repurchase solely to the extent that stock of the target corporation is exchanged by target corporation shareholders for qualifying property, regardless of whether the target corporation shareholder recognizes any gain or loss. One stakeholder recommended this third approach based on the stakeholder's rationale that shareholder-level gain should not be taken into account for determining whether a repurchase occurred for purposes of the stock repurchase excise tax. In addition, the stakeholder contended that any approach that requires computation of each shareholder's gain or loss would be difficult for the IRS to administer, and for taxpayers to apply with certainty, because the shareholder-level data necessary to determine such gain or loss would be difficult to obtain.

The Treasury Department and the IRS continue to be of the view that the third approach recommended by stakeholders would strike the most appropriate balance between implementing the plain language of the reorganization exception and providing a rule that facilitates the ability of the IRS to administer and enforce the stock repurchase excise tax. Under this approach, the touchstone consideration of whether a target corporation shareholder receives qualifying or non-qualifying property in exchange for target corporation stock will enable target corporations to readily determine the extent to which the reorganization exception applies to the exchange. Moreover, the Treasury Department and the IRS are of the view that only in rare instances would such a shareholder not recognize gain or loss if the shareholder received non-qualifying property in exchange for target corporation stock. Accordingly, the proposed regulations would retain the approach described in Notice 2023–2. *See* proposed § 58.4501–3(c).

2. Section 355 Transactions That are Not Part of a D Reorganization

Stakeholders recommended applying the reorganization exception to split-offs and split-ups without regard to whether the section 355 transaction occurs as part of a D reorganization. According to the stakeholders, Congress intended to convey through the reorganization exception that transactions that qualify for non-recognition treatment should not be subject to the stock repurchase excise tax, and that the same treatment should extend to all section 355 transactions—regardless of whether carried out as part of a D reorganization.

The Treasury Department and the IRS continue to be of the view that the exception in section 4501(e)(1) should apply to split-offs to which section 355 applies without regard to whether such transactions occur as part of a D reorganization. *See* proposed § 58.4501–3(c). As previously discussed in part IX.A of this Explanation of Provisions, split-ups are not treated as repurchases. Consequently, the exception in section 4501(e)(1) is not relevant to split-ups.

B. Contributions to Employer-Sponsored Retirement Plans

In general, under section 3.07(3)(a) of Notice 2023–2, the fair market value of stock repurchased by a covered corporation is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base if the stock that is repurchased, or an amount of stock equal to the fair market value of the stock repurchased, is contributed to an employer-sponsored retirement plan.

1. Timing of Contributions Under Section 4501(e)(2)

Section 4501(e)(2) provides that the stock repurchase excise tax does not apply in any case in which the stock repurchased, or an amount of stock equal to the value of the stock repurchased, is contributed to an employer-sponsored retirement plan, ESOP, or similar plan (stock contribution exception).

Under section 3.07(3)(d) of Notice 2023–2, a covered corporation may treat stock contributions to an employer-sponsored retirement plan under the stock contribution exception as having been made in the prior taxable year if the stock is contributed by the filing deadline for the IRS Form 720, *Quarterly Federal Excise Tax Return,* that is due for the first full quarter after the close of the taxpayer's taxable year and on account of that taxable year within the meaning of section 404(a)(6) of the Code. The rule described in section 3.07(3)(d) of Notice 2023–2 also provides stock contributions that are treated as having been contributed in the taxable year to which the Form 720 applies may not be treated as having been contributed for any other taxable year.

One stakeholder indicated that the reference to the stock contribution being ''on account of'' the taxable year within the meaning of section 404(a)(6) raises questions about the timing of the offset for the stock repurchase excise tax and the income tax deduction under section 404(a). Specifically, the stakeholder requested clarification as to whether a covered corporation is required to deduct a stock contribution to a plan under section 404(a) in the same taxable year for which the contribution is taken into account for purposes of the stock contribution exception.

The Treasury Department and the IRS are of the view that a stock contribution is not required to be treated as ''on account of'' the preceding taxable year within the meaning of section 404(a)(6). Thus, for example, a covered corporation may claim the income tax deduction in the taxable year in which the stock is contributed to the employer-sponsored retirement plan but claim an offset for the stock contribution to the plan for purposes of the stock repurchase excise tax in the preceding taxable year (provided that the rules in these proposed regulations are satisfied).

Accordingly, these proposed regulations would provide that, for purposes of the reduction in the stock repurchase excise tax base, a covered corporation may treat stock

contributions to an employer-sponsored retirement plan made after the close of the covered corporation's taxable year as having been contributed during that taxable year if two conditions are satisfied. First, the stock must be contributed to the employer-sponsored retirement plan by the filing deadline for the form on which the stock repurchase excise tax must be reported that is due for the first full quarter after the close of the taxpayer's taxable year. Second, the stock must be treated by the employer-sponsored retirement plan in the same manner that the plan would treat a contribution received on the last day of the preceding taxable year. *See* proposed § 58.4501–3(d)(4)(ii).

2. Definition of ''Employer-Sponsored Retirement Plan''

For purposes of Notice 2023–2, the term ''employer-sponsored retirement plan'' means a retirement plan maintained by a covered corporation that is qualified under section 401(a) of the Code, including an ESOP (as defined in section 4975(e)(7) of the Code). *See* section 3.02(12) of Notice 2023–2. In section 6.01(4) of Notice 2023–2, the Treasury Department and the IRS requested comments regarding whether the definition of an ''employer-sponsored retirement plan'' should include plans other than plans that are qualified under section 401(a). In response, one stakeholder recommended expanding this definition to include foreign-based plans and plans funded through a secular trust. The stakeholder reasoned that the statutory language of section 4501(e)(2), along with the underlying policy considerations, support expanding the definition to these types of plans. However, the stakeholder did not specify which types of foreign-based plans or plans funded through a secular trust should be included in the definition of an ''employer-sponsored retirement plan.''

The Treasury Department and the IRS are of the view that certain broad-based foreign plans that are funded through a secular trust or another type of funded arrangement may be considered ''similar plans,'' and thus may be included in the definition of an ''employer-sponsored retirement plan'' for purposes of the stock contribution exception. However, the Treasury Department and the IRS have not yet determined which types of broad-based foreign plans should be included in this definition. Accordingly, the Treasury Department and the IRS request comments regarding the types of foreign-based plans that should be included in the definition of an ''employer-sponsored retirement plan.''

Another stakeholder expressed concern that the stock contribution exception could be used to encourage excessive executive compensation and requested that the definition of ''similar plan'' be defined to specifically exclude executive compensation arrangements. The Treasury Department and the IRS agree that the stock contribution exception should not be used to encourage executive compensation arrangements. The definition of an ''employer-sponsored retirement plan'' described in Notice 2023–2 is limited to plans that are qualified under section 401(a) (including ESOPs). The Treasury Department and IRS are of the view that this definition is sufficient to exclude executive compensation arrangements from the stock contribution exception. Thus, these proposed regulations similarly would limit the definition of ''employer-sponsored retirement plan'' to plans that are qualified under section 401(a).

However, these proposed regulations would expand the definition of ''employer-sponsored retirement plan'' described in Notice 2023–2 to include qualified plans under section 401(a) that are maintained by specified affiliates of covered corporations. Section 3.02(12) of Notice 2023–2 defined ''employer-sponsored retirement plan'' with regard to qualified plans maintained by covered corporations. These proposed regulations would provide that the definition of ''employer-sponsored retirement plan'' includes not only qualified plans maintained by covered corporations, but also qualified plans maintained by a specified affiliate of a covered corporation. *See* proposed § 58.4501–1(b)(11).

3. Valuation of Stock Contributions

As noted previously, the stock contribution exception in section 4501(e)(2) provides that the stock repurchase excise tax will not apply in any case in which (i) the stock repurchased (first clause), or (ii) an amount of stock equal to the value of the stock repurchased (second clause), is contributed to an employer-sponsored retirement plan, ESOP, or similar plan.

Section 3.07(3)(c)(i) of Notice 2023–2 addressed the first clause by providing that, if a covered corporation repurchases stock and contributes to an employer-sponsored retirement plan stock of the same class, then the amount of the reduction under the stock contribution exception is equal to the aggregate fair market value of the stock repurchased during the taxable year, divided by the number of shares repurchased, and multiplied by the number of shares contributed. However, the amount of the reduction may not exceed the aggregate fair market value of stock of the same class repurchased during the taxable year.

Section 3.07(3)(c)(ii) of Notice 2023–2 addressed the second clause by providing that, if a covered corporation contributes to an employer-sponsored retirement plan stock of a different class than the class of stock that was repurchased, then the amount of the reduction under the stock contribution exception is equal to the fair market value of the stock at the time the stock is contributed to the employer-sponsored retirement plan. However, the amount of the reduction may not exceed the aggregate fair market value of stock of a different class repurchased during the taxable year.

One stakeholder requested that the value of stock for purposes of the stock contribution exception be based on the greater of the value at the time of repurchase or at the time of contribution to an employer-sponsored retirement plan. The stakeholder stated that the word ''or'' between the first clause and the second clause offers statutory support for allowing covered corporations to choose between using the first clause or the second clause for any given year.

The Treasury Department and the IRS disagree with the stakeholder. With regard to the first clause, the focus of the language is on *the* stock repurchased. Because the stock repurchase excise tax does not apply to the repurchase of *the* stock that is contributed, the amount of the offset is the fair market value of the shares of stock at the time of the repurchase. Any change in value after the date of repurchase is irrelevant for purposes of determining the amount of the repurchase under section 4501(a) and, thus, the offset amount under the stock contribution exception.

Moreover, if covered corporations contribute stock of a different class than the stock repurchased, the contribution will not reflect a contribution of *the* stock repurchased. For this reason, it is inconsistent with the statutory language of section 4501(e)(2) to allow covered corporations to apply the first clause if contributing a different class of stock to an employer-sponsored retirement plan.

With regard to the second clause, because the statutory language focuses on an amount of stock *equal to the value of* the stock repurchased, and not on the shares of stock themselves, the value of the offset amount is determined by the value of the stock contributed to the retirement plan, instead of the value of the stock at the time of the repurchase.

Accordingly, these proposed regulations would incorporate the

valuation provisions described in section 3.07(3)(c) of Notice 2023–2, including the rule that the reduction cannot exceed the aggregate fair market value of the stock repurchased. Additionally, these proposed regulations would add language to coordinate the application of the stock contribution exception with the application of other statutory exceptions. *See* proposed § 58.4501–3(d)(3).

4. Special Rule for Leveraged ESOPs

As defined in section 4975(e)(7), an ESOP is a type of defined contribution plan that is qualified under section 401(a) and is designed to invest primarily in qualifying employer securities (within the meaning of section 409(l) of the Code). An ESOP also must meet other applicable requirements described in section 409.

An ESOP may be leveraged or non-leveraged. Leveraged ESOPs use the proceeds of an exempt loan (as defined in section 4975(d)(3)) from the sponsoring employer or another party (typically with the employer's guarantee) to purchase qualifying employer securities from the sponsoring employer or shareholders or on a securities market. The purchased securities are held in a suspense account (within the trust that forms a part of the plan) as collateral for the loan. The sponsoring employer makes cash contributions to the ESOP, which in turn uses the cash to make loan repayments. Dividends paid on shares held as collateral in the ESOP loan suspense account and on shares allocated to participants' accounts also may be used to repay an exempt loan. As loan repayments are made, securities are released from the suspense account and allocated to ESOP participants' accounts in accordance with the terms of the plan, which must comply with plan qualification and fiduciary requirements.

Non-leveraged ESOPs do not have a loan and, thus, do not have a suspense account that releases securities to ESOP participants' accounts as contributions of cash are used to repay a loan. Rather, employers contribute employer securities directly to the non-leveraged ESOP, and the contributed shares are allocated to ESOP participants' accounts as of the plan year to which the contribution applies.

Employer contributions to a non-leveraged ESOP fit squarely within the stock contribution exception because employer contributions to a non-leveraged ESOP are made in shares of stock. Although employer contributions of cash to a leveraged ESOP are not described in section 4501(e)(2), such contributions result in the allocation of shares of stock from a suspense account to ESOP participants' accounts. In other words, contributions of stock to a non-leveraged ESOP and contributions of cash to a leveraged ESOP that is used to repay an exempt loan produce a comparable result—namely, the allocation of employer stock to participants' accounts. Accordingly, the Treasury Department and the IRS are of the view that leveraged ESOPs and non-leveraged ESOPs should be treated similarly for purposes of the stock contribution exception.

Thus, these proposed regulations would provide that, if a covered corporation maintains a leveraged ESOP, stock that is released from a suspense account (as a result of cash contributions by the employer maintaining the plan) and allocated to ESOP participants' accounts is treated as a stock contribution for purposes of the stock contribution exception as of the date stock attributable to repayment of the exempt loan is released from the suspense account and allocated to participants' accounts. Because dividends on employer stock held in the ESOP and used to repay an exempt loan are not employer contributions, stock released from the suspense account that is attributable to repayment of the loan with dividends would not be treated as a stock contribution for purposes of the stock contribution exception. *See* proposed § 58.4501–3(d)(1)(ii).

C. De Minimis Exception

Section 4501(e)(3) provides an exception (that is, the de minimis exception) to the application of the stock repurchase excise tax with regard to a taxable year ''in any case in which the total value of the stock repurchased during the taxable year does not exceed $1,000,000.'' *See* section 4501(e)(3); *see also* section 3.03(2)(a) of Notice 2023–2. Under section 3.03(2)(b) of Notice 2023–2, the determination of whether the de minimis exception applies with regard to a taxable year is made before applying any other statutory exception or any adjustments under the netting rule. As discussed in part XIV.A.3 of this Explanation of Provisions, the Treasury Department and the IRS are of the view that applying the de minimis exception before the other statutory exceptions is consistent with the statutory language and structure of section 4501.

The proposed regulations would retain the approach described in Notice 2023–2. *See* proposed § 58.4501–2(c)(3). Additionally, for the same rationale underlying the approach described in Notice 2023–2, the proposed regulations would clarify that repurchases prior to January 1, 2023, are not taken into account for purposes of the stock repurchase excise tax (including for purposes of applying the de minimis exception). *See* proposed § 58.4501–2(c)(4); *see also* part I.A of this Explanation of Provisions (discussion of repurchases by a fiscal-year taxpayer prior to the effective date).

D. Repurchases by Dealers in Securities

Section 4501(e)(4) provides an exception to the application of the stock repurchase excise tax ''under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business.'' Pursuant to the authority granted in section 4501(e)(4), section 3.07(4) of Notice 2023–2 describes an exception to the application of the stock repurchase excise tax for certain repurchases by a dealer in securities in the ordinary course of the dealer's business of dealing in securities.

More specifically, section 3.07(4)(a) of Notice 2023–2 describes, in part, that the fair market value of stock repurchased by a covered corporation that is a dealer in securities (within the meaning of section 475(c)(1) of the Code) is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base to the extent the stock is acquired in the ordinary course of the dealer's business of dealing in securities. However, under section 3.07(4)(b) of Notice 2023–2, this reduction applies solely to the extent that: (i) the dealer accounts for the stock as securities held primarily for sale to customers in the dealer's ordinary course of business; (ii) the dealer disposes of the stock within a period of time that is consistent with the holding of the stock for sale to customers in the dealer's ordinary course of business, taking into account the terms of the stock and the conditions and practices prevailing in the markets for similar stock during the period in which the stock is held; and (iii) the dealer does not sell or otherwise transfer the stock to certain specified persons other than in a sale or transfer to a dealer that also satisfies the requirements of section 3.07(4) of Notice 2023–2.

No feedback was received on this exception in Notice 2023–2. The proposed regulations would retain the approach described in Notice 2023–2. *See* proposed § 58.4501–3(e).

E. Repurchases by RICs and REITs

Section 4501(e)(5) provides an exception to the application of the stock

repurchase excise tax for ''repurchases by a regulated investment company (as defined in section 851) or a real estate investment trust.'' Under section 3.07(5) of Notice 2023–2, a repurchase by a covered corporation that is a RIC or a REIT is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base. The proposed regulations would retain the approach described in Notice 2023–2.

A stakeholder recommended that the exception for RICs be extended to all funds registered under the Investment Company Act of 1940, even if those funds do not qualify as RICs for tax purposes. The stakeholder suggested that the organizational structure, operations, applicable securities laws, and accounting standards are the same for those funds as for funds that are RICs for tax purposes.

The Treasury Department and the IRS disagree with the stakeholder's recommendation. Section 4501(e)(5) provides a specific and limited exception for RICs as defined in section 851, and nothing in the statutory language of section 4501 suggests that entities that do not qualify as RICs are intended to be exempt from the stock repurchase excise tax. Accordingly, the proposed regulations would not adopt this recommendation.

F. Dividend Exception

Section 4501(e)(6) provides an exception (dividend exception) to the application of the stock repurchase excise tax ''to the extent that the repurchase is treated as a dividend for purposes of [the Code].'' To implement section 4501(e)(6), the rule described in section 3.07(6)(a) of Notice 2023–2 generally provides that the fair market value of stock repurchased by a covered corporation is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base to the extent the repurchase is treated as a distribution of a dividend under section 301(c)(1) or 356(a)(2). Under the notice, there is a rebuttable presumption that a repurchase to which section 302 or 356(a) applies is subject to section 302(a) or 356(a)(1), respectively (and, therefore, is ineligible for the foregoing exception). *See* section 3.07(6)(b)(i) of Notice 2023–2. A covered corporation may rebut this presumption with regard to a specific shareholder solely by establishing with sufficient evidence that the shareholder treats the repurchase as a dividend on the shareholder's Federal income tax return. *See* section 3.07(6)(b)(ii) of Notice 2023–2.

1. Substantiation for Dividend Exception

Stakeholders provided several recommendations regarding substantiation for the dividend exception in section 4501(e)(6).

a. Reliance on Filings With the U.S. Securities and Exchange Commission

One stakeholder requested guidance as to how corporations should apply the constructive ownership rules of section 318(a) of the Code in determining the extent to which redemptions are treated as in part or full payment in exchange for stock under section 302(a) or as distributions to which section 301 applies. The stakeholder recommended that such guidance: (i) should permit corporations to rely on filings with the U.S. Securities and Exchange Commission (SEC) and similar filings to determine ownership (as in the case of determining whether an ownership change has occurred for purposes of section 382 of the Code (*see* § 1.382–2T(k)(1)(i))); (ii) should clarify the requisite level of due diligence to determine the constructive ownership of any shareholders not required to report their ownership in SEC filings; and (iii) should address whether any safe harbors or presumptions are available.

The Treasury Department and the IRS are of the view that the rebuttable presumption approach described in Notice 2023–2 would provide a more accurate determination of whether a covered corporation qualifies for the dividend exception. In addition, the Treasury Department and the IRS are of the view that the rebuttable presumption approach would better facilitate the IRS's ability to administer and enforce the stock repurchase excise tax and enable taxpayers to apply the tax with greater certainty. Therefore, the proposed regulations would not permit covered corporations to rely on filings with the SEC and similar filings to determine the extent to which redemptions may be treated as qualifying for the dividend exception.

b. Rebuttable Presumption and Substantiation Requirements

Another stakeholder contended that a covered corporation generally would not have access to information to determine with certainty whether a section 317(b) redemption should be treated as a dividend with respect to a particular shareholder. For support, the stakeholder asserted that a covered corporation may not possess information specifying the identity of its shareholders, which complicates the ability of the covered corporation to determine whether a repurchase is properly treated as a sale or exchange under section 302(a) or as a section 301 distribution under section 302(d) (which depends on shareholder-specific facts). As a result, the stakeholder recommended a safe harbor under which the dividend exception would apply if the covered corporation: (i) provides information reporting to the redeemed shareholder providing that the repurchase constitutes a dividend; (ii) obtains certification from the shareholder that the repurchase constitutes a section 302(d) redemption; (iii) has no knowledge of facts that would indicate that the certification is incorrect; and (iv) demonstrates that the corporation has sufficient earnings and profits (E&P) to treat the deemed section 301 distribution as a dividend.

As reflected in section 3.07(6) of Notice 2023–2, the Treasury Department and the IRS are of the view that repurchases should be presumed not to be dividend-equivalent (that is, the dividend exception is presumed to be inapplicable), but that taxpayers should be permitted to rebut this presumption by providing sufficient evidence. The substantiation requirements described in section 3.07(6)(b)(iii) of Notice 2023–2 are substantially similar to the stakeholder's recommended safe harbor, with the additional requirement that the shareholder must provide evidence that applicable withholding occurred, if required.

Coupled with the shareholder certification requirement, the Treasury Department and the IRS provided the information reporting requirement to ensure that covered corporations and their shareholders treat repurchases consistently for purposes of the dividend exception. However, it is the understanding of the Treasury Department and the IRS that publicly traded stock typically is held by shareholders through a broker, and the broker (rather than the issuer of the stock) provides any information reporting to the shareholder. Under current law, brokers are not required to inform the issuer of the stock what information reporting the brokers have provided to shareholders, and the Treasury Department and the IRS understand that brokers generally do not provide such information to issuers. Consequently, in such cases, there is no assurance that the information reporting provided to the shareholder would be consistent with the covered corporation's treatment of a repurchase. Therefore, the proposed regulations would replace the information reporting requirement with a requirement that the covered corporation treat the repurchase

consistent with the shareholder certification.

c. Coordination With Withholding Tax Rules

In section 6.01(7) of Notice 2023–2, the Treasury Department and the IRS requested comments on whether there should be modifications to the method described in section 3.07(6) of Notice 2023–2, or whether additional methods to rebut the presumption should be permitted.

In response, one stakeholder observed that, although Notice 2023–2 includes a rebuttable presumption that a share repurchase by a covered corporation constitutes a sale or exchange, the withholding tax rules generally presume that such share repurchases from foreign persons are dividends subject to withholding tax. *See* § 1.1441–3(c)(1). In the absence of coordination, the stakeholder contended that each of these presumptions might apply to the same transaction, and therefore would require (i) the repurchasing corporation to pay the stock repurchase excise tax as if the payment gave rise to a sale or exchange, and (ii) a withholding agent to withhold as if the payment gave rise to a dividend. Accordingly, the stakeholder requested that the proposed regulations provide rules to coordinate these differing presumptions.

The Treasury Department and the IRS are of the view that no special rules are needed to coordinate the foregoing presumptions, particularly because these presumptions serve different purposes. In addition, if the proposed regulations were to provide rules to coordinate these presumptions, then the following would result: (i) covered corporations making repurchases would not have any stock repurchase excise tax liability (if the presumption were that all repurchases are dividends); or (ii) corporations making section 302 distributions to foreign persons would not have any withholding tax liability (if the presumption were that all repurchases are sales or exchanges).

However, the proposed regulations would include rules to coordinate the proposed shareholder certification requirements under the dividend exception with the proposed section 302 payment certification requirements under proposed § 1.1441–3(c)(5)(iii)(D). *See* proposed § 58.4501–3(g)(3).

d. Certification From Foreign Shareholders

Another stakeholder contended that the requirement that U.S. companies obtain certification from a foreign shareholder who does not file a U.S. tax return, and who does not otherwise have a U.S. tax connection, is excessively burdensome. The stakeholder recommended replacing the certification requirement with the requirement that a U.S. company provide a Form 1042–S showing payment of a dividend.

The Treasury Department and the IRS are of the view that reliance solely on the Form 1042–S is not an appropriate replacement for the shareholder certification requirement, because the Form 1042–S is based on the presumption that share repurchases are dividends subject to withholding tax. Consequently, reliance solely on the Form 1042–S for purposes of substantiating the dividend exception could overstate the amount of repurchases that qualify for this exception. Accordingly, the proposed regulations would not adopt this recommendation.

2. Substantiation of Dividend Exception for E Reorganizations

As discussed in part VIII.D of this Explanation of Provisions, the proposed regulations would provide that a covered corporation's acquisition of its stock as part of an E reorganization would constitute a repurchase, subject to the reorganization exception. Stakeholders have asked whether a covered corporation may establish its eligibility for the dividend exception by demonstrating that (i) § 1.301–1(j) applies to the non-qualifying property in the transaction, and (ii) the corporation has sufficient E&P for dividend treatment.

Section 1.301–1(j) provides, in relevant part, that a distribution to shareholders with respect to their stock is a section 301 distribution, even if the distribution occurs at the same time as another transaction, if the distribution is in substance a separate transaction (whether or not connected in a formal sense). Section 1.301–1(j) further provides that this situation is most likely to occur in the case of a recapitalization and certain other corporate reorganizations. For example, if a corporation with only common stock outstanding exchanges one share of newly issued common stock and one bond for each share of outstanding common stock, the distribution of the bond is a distribution of property (to the extent of its fair market value) to which section 301 applies even if the stock-for-stock exchange is pursuant to an E reorganization.

Notice 2023–2 does not expressly address the interaction of § 1.301–1(j) and the dividend exception. However, the presumption that a repurchase by a covered corporation constitutes a sale or exchange applies only to a repurchase to which section 302 or 356(a) applies. *See* section 3.07(6)(b)(i) of Notice 2023–2.

The Treasury Department and the IRS are of the view that no special rules are needed in response to the stakeholders' query. In other words, because a distribution of non-qualifying property that is treated as a section 301 distribution pursuant to § 1.301–1(j) is not subject to section 302 or 356(a), the Treasury Department and the IRS are of the view that such a distribution should qualify for the dividend exception (if the covered corporation has sufficient E&P) without the need for the covered corporation to rebut the presumption that the repurchase is a sale or exchange. The proposed regulations would reflect this position. *See* proposed § 58.4501–3(g)(2).

3. Dividend Exception and Partial Liquidation Look-Through Rule

A stakeholder requested that the proposed regulations provide the manner in which covered corporations should apply the look-through rule of section 302(e)(5) in determining the extent to which redemptions in partial liquidation are made to corporate shareholders (and, therefore, are potentially eligible for the dividend exception). Under section 302(b)(4), a redemption in partial liquidation to noncorporate shareholders is treated as a sale or exchange rather than as a section 301 distribution. However, section 302(b)(4) does not apply to shareholders that are not corporations. As a result, such shareholders potentially are eligible for exclusion under the dividend exception.

Section 302(e)(5) provides that, for purposes of determining under section 302(b)(4) whether any stock is held by a shareholder that is not a corporation, any stock held by a partnership, estate, or trust is treated as if it were held proportionately by its partners or beneficiaries. For purposes of applying this rule, the stakeholder recommended that the proposed regulations permit covered corporations to rely on SEC filings and similar filings. For support, the stakeholder contended that covered corporations generally cannot ascertain the identity of their shareholders unless the shareholders are required to disclose their ownership under applicable securities law.

For the reasons previously discussed in part X.F.1 of this Explanation of Provisions, the Treasury Department and the IRS are of the view that corporations should not be permitted to rely solely on SEC filings or similar filings for purposes of determining whether the dividend exception in

section 4501(e)(6) applies. Accordingly, the proposed regulations would not adopt this recommendation. Instead, the proposed regulations would provide that covered corporations must obtain certifications from their shareholders, which must take section 302(e)(5) into account for purposes of making the certification. *See* proposed § 58.4501–3(g)(2)(ii).

XI. Netting Rule

A. Overview

Section 4501(c)(3) allows an adjustment for stock issued by a covered corporation, including stock issued or provided to employees of a covered corporation or its specified affiliate. Section 3.08 of Notice 2023–2 describes rules regarding the adjustment under section 4501(c)(3) (that is, the netting rule).

In general, under section 3.08(1) of Notice 2023–2, the stock repurchase excise tax base with regard to a taxable year of a covered corporation is reduced by the aggregate fair market value of stock of the covered corporation (i) issued or provided to employees of the covered corporation or employees of a specified affiliate during the covered corporation's taxable year, and (ii) issued by the covered corporation to other persons during the covered corporation's taxable year. For these purposes, stock is treated as issued or provided by a covered corporation at the time at which, for Federal income tax purposes, ownership of the stock transfers to the recipient. *See* section 3.08(2) of Notice 2023–2.

Section 3.08(3) of Notice 2023–2 describes additional rules regarding stock issued or provided to an employee of a covered corporation or specified affiliate as compensation for services performed as an employee. Such arrangements include transfers of stock in connection with the performance of services described in section 83, including pursuant to a nonqualified stock option, or pursuant to a stock option described in section 421 of the Code.

B. Treasury Stock

A stakeholder requested confirmation that the transfer of treasury stock is treated as an issuance for purposes of the netting rule to the same extent as the transfer of newly issued stock. The stakeholder contended that treasury stock generally is treated in the same manner as the issuance of new stock for Federal income tax purposes, and that there is no countervailing policy reason for treating treasury stock differently than newly issued stock for purposes of the netting rule. Notice 2023–2 does not expressly address the treatment of treasury stock because the Treasury Department and the IRS are of the view that treasury stock constitutes stock for Federal income tax purposes.

The Treasury Department and the IRS continue to be of the view that treasury stock constitutes stock for Federal income tax purposes. For the avoidance of doubt, the proposed regulations would provide explicitly that transfers of treasury stock (within the meaning of section 317(b)) are taken into account for purposes of the netting rule to the same extent as transfers of newly issued stock. *See* proposed § 58.4501–1(b)(29).

C. Transactions Not Treated as Issuances for Purposes of the Netting Rule

Under section 3.08(4) of Notice 2023–2, the following stock is not treated as issued for purposes of the netting rule: (i) stock of a covered corporation distributed by the covered corporation to its shareholders with respect to its stock; (ii) stock issued by a covered corporation to a specified affiliate of the covered corporation; (iii) stock treated as issued by the acquiring corporation by reason of the application of section 304(a)(1) to a transaction; (iv) certain fractional shares (*see* the discussion in part XIV.B of this Explanation of Provisions); (v) stock issued by a covered corporation that is a dealer in securities (to the extent the stock is issued, or otherwise is used to satisfy obligations to customers arising, in the ordinary course of the dealer's (or an applicable acquiror's) business of dealing in securities); and (vi) stock issued by the target corporation to the merged corporation in exchange for consideration that includes the stock of the controlling corporation in a reverse triangular merger. *See* sections 3.08(4)(b), (c), (e), (f), (g), and (h), respectively, of Notice 2023–2.

Additionally, under section 3.08(4)(d) of Notice 2023–2, stock issued as part of a transaction qualifying as a reorganization under section 368(a) or a distribution under section 355 is not treated as issued by the issuing corporation if (i) the stock constitutes qualifying property, (ii) the stock is used by a covered corporation to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(i), (ii), (iii), or (iv) of Notice 2023–2 (*see* the discussion in parts VIII.A, D, and E and IX of this Explanation of Provisions), and (iii) the repurchase is not included in the covered corporation's stock repurchase excise tax base because that repurchase is a qualifying property repurchase (within the meaning of section 3.07(2) of Notice 2023–2).

Under section 3.07(3)(e) of Notice 2023–2, stock contributions to an employer-sponsored retirement plan under the stock contribution exception are not treated as issued or provided to employees of the covered corporation or a specified affiliate under the netting rule.

1. Issuances to Specified Affiliates

Stakeholders generally recommended that issuances of stock to a specified affiliate should not be taken into account for purposes of the netting rule, for several reasons. First, respecting such issuances might lead to double counting if the stock is treated as ''issued'' to a specified affiliate and subsequently ''provided'' to that specified affiliate's employees. *See* section 4501(c)(3). Second, because section 4501(c)(2) treats the acquisition of stock of a covered corporation by a specified affiliate (from a person who is not the covered corporation or a specified affiliate of such covered corporation) as a repurchase of stock of the covered corporation, allowing such a repurchase to be offset by acquisitions of the covered corporation's stock by the specified affiliate from the covered corporation itself would be incongruous. Third, issuances of stock to a specified affiliate do not promote what the stakeholder considered to be the congressional policies underlying section 4501 (for example, promoting investment in productive capital or labor).

Under section 3.08(4)(c) of Notice 2023–2, stock issued by a covered corporation to a specified affiliate is not treated as issued. Stakeholders found this exception to the netting rule to be sensible insofar as it prevents covered corporations from eroding their stock repurchase excise tax base by creating ''hook stock'' (that is, issuing corporation stock held by an entity that is owned, directly or indirectly, by the issuing corporation).

However, stakeholders also suggested that the scope of this exception is overbroad. Under a strict reading, this exception would permanently prevent the issued stock from being taken into account under the netting rule (for example, if provided to an employee of the specified affiliate), because any subsequent transfer by the specified affiliate would not technically constitute an ''issuance.'' Stakeholders recommended that issuances of stock by a covered corporation to its specified affiliate be disregarded only to the extent the covered corporation stock is not subsequently transferred to a party

other than the covered corporation or another specified affiliate.

The Treasury Department and the IRS agree with the stakeholders. Accordingly, the proposed regulations would clarify that stock issued by a covered corporation to a specified affiliate is treated as issued for purposes of the netting rule if and when that stock is transferred by the specified affiliate during the same taxable year to a person who is not the covered corporation or a specified affiliate of that corporation, so long as (1) the covered corporation does not otherwise reduce its stock repurchase excise tax base for the issuing year with respect to the stock, and (2) the subsequent transfer by the specified affiliate is not in connection with the performance of services provided to the specified affiliate. *See* proposed § 58.4501–4(f)(2). The first requirement is intended to ensure that the stock is not double counted if, for example, the stock is ''issued'' to the specified affiliate and subsequently ''provided'' to the specified affiliate's employees. The second requirement is intended to ensure that stock transferred to a non-employee service provider of a specified affiliate would not qualify under this rule. *See* part XI.G of this Explanation of Provisions (explaining the interpretation in the proposed regulations of section 4501(c)(3)'s ''issued or provided'' language). Unless specifically identified, the shares of stock of the covered corporation treated as subsequently transferred by the specified affiliate are the earliest shares issued by the covered corporation to the specified affiliate. *See* proposed § 58.4501–4(f)(2)(iii).

Under the proposed regulations, stock issued by a covered corporation in connection with the performance of services for a specified affiliate would not be treated as ''issued'' for purposes of the netting rule. However, a transfer of stock of a covered corporation described in § 1.83–6(d) by a specified affiliate to an employee (but not a non-employee service provider) of the specified affiliate would be treated as ''provided'' by the specified affiliate. *See* proposed § 58.4501–4(f)(2)(iv).

Thus, under the proposed regulations, stock issued by a covered corporation to its specified affiliate (or stock that is treated as so issued under § 1.83–6(d)) would be counted for purposes of the netting rule under two different provisions depending on whether the subsequent transfer by the specified affiliate is in connection with the performance of services. First, if the subsequent transfer is not in connection with the performance of services, then the stock transferred would be counted as stock ''issued'' by the covered corporation if and when the stock is transferred, during the same taxable year as the original issuance, to a person who is not the covered corporation or a specified affiliate of the corporation. Second, if the subsequent transfer (or deemed transfer under § 1.83–6(d)) is in connection with the performance of services, then the stock transferred would be counted as stock ''provided'' by the specified affiliate, but only if the stock is transferred to an employee of the specified affiliate. Stock transferred to a non-employee service provider of a specified affiliate would not be counted for purposes of the netting rule. *See* part XI.G.2 of this Explanation of Provisions.

2. Issuances in Acquisitive Reorganizations and Split-Offs (No Double Benefit Rule)

The Treasury Department and the IRS are of the view that stock issued by the acquiring corporation to the target corporation as part of an acquisitive reorganization should not be treated as an issuance for purposes of the netting rule. *See* section 3.08(4)(d) of Notice 2023–2. It is the position of the Treasury Department and the IRS that allowing such an issuance to be taken into account for purposes of the netting rule would create a ''double benefit'' (that is, two reductions to the stock repurchase excise tax base with respect to the same stock). In other words, (i) one reduction would be provided to the target corporation under the reorganization exception (*see* section 3.07(2) of Notice 2023–2) for the use of acquiring corporation stock to repurchase target corporation stock, and (ii) a second reduction would be provided to the acquiring corporation for the issuance of that acquiring corporation stock under the netting rule. The Treasury Department and the IRS observe that the identical concern arises with regard to stock issued by Controlled to Distributing in a D reorganization occurring as part of a split-off under section 355.

One stakeholder asserted that, if the proposed regulations adopt the stakeholders' recommendation to exclude acquisitive reorganizations from the stock repurchase excise tax, no ''double benefit'' would occur because the issuance of qualifying property by the acquiring corporation would not be offset against the target corporation's stock repurchase excise tax base. However, the proposed regulations would not adopt the recommendation to exclude acquisitive reorganizations from the stock repurchase excise tax. *See* part VIII.A.2 of this Explanation of Provisions.

Based on the foregoing, the proposed regulations would provide that stock issued as part of a transaction qualifying as a reorganization under section 368(a) or as a distribution under section 355 is disregarded for purposes of the netting rule if (i) the stock constitutes qualifying property, (ii) the stock is used by a covered corporation to repurchase its stock in a transaction qualifying as a reorganization under section 368(a) or a split-off under section 355 (whether or not the split-off is part of a D reorganization), and (iii) that repurchase is not included in that corporation's stock repurchase excise tax base because the repurchase is a qualifying property repurchase. *See* proposed § 58.4501–4(f)(3).

3. Issuances in Spin-Offs and Split-Ups

A stakeholder also recommended that issuances by Controlled to Distributing in a D reorganization occurring as part of a section 355 distribution should not be treated as issuances for purposes of the netting rule if the section 355 distribution is either a split-off or a spin-off. The stakeholder noted that, under Notice 2023–2, the no double benefit rule does not disregard the Controlled stock issued to Distributing in a D reorganization occurring as part of a spin-off because, unlike in a split-off, Distributing does not use the Controlled stock to repurchase its own stock. However, the stakeholder found no policy justification for the disparate treatment of spin-offs and split-offs that qualify under section 355 with respect to the netting rule. The stakeholder also questioned the propriety of allowing a recently distributed Controlled to begin its life as a covered corporation with a positive ''reserve'' of issuances equal to its net value for purposes of the netting rule.

The Treasury Department and the IRS agree with the stakeholder and are of the view that Controlled stock issued to Distributing in a section 355 transaction should be disregarded for purposes of the netting rule. Thus, the proposed regulations would provide that any stock issued by Controlled in a distribution qualifying under section 355 (or so much of section 356 as relates to section 355) is not treated as an issuance for purposes of the netting rule. *See* proposed § 58.4501–4(f)(9).

4. Section 305 Distributions

Under section 3.08(4)(b) of Notice 2023–2, stock of a covered corporation distributed by the covered corporation to its shareholders with respect to its stock is not treated as issued for

purposes of the netting rule. Several stakeholders recommended that stock issued by a covered corporation in a distribution to which section 305(a) of the Code applies (for example, a pro rata stock distribution) should not be taken into account for purposes of the netting rule. These stakeholders reasoned that, if their recommendation were not adopted, a covered corporation could avoid the stock repurchase excise tax by engaging in transactions that create share issuances for the netting rule but have no meaningful dilutive effect on the covered corporation's equity capital. In support of this recommendation, one stakeholder analogized a section 305(a) distribution to a circular flow of cash (that is, the distribution of cash by a corporation to its shareholders, followed by the reinvestment of all the distributed cash in the corporation) that is disregarded for Federal income tax purposes. The stakeholder contended that such a transaction should not be treated as creating a stock issuance for purposes of the netting rule.

With regard to distributions by a covered corporation that are described in section 305(b), stakeholders recommended that issuances of stock by the covered corporation *should* be taken into account for purposes of the netting rule if the receipt of that stock is taxable to the shareholder under section 305(b). As one example, stakeholders suggested that such distributions should be treated as share issuances for purposes of the netting rule if any distributee shareholder can elect to be paid either in stock or in property under section 305(b)(1). The stakeholders asserted that the ability of distributee shareholders to elect to receive stock or cash (or other property) in a section 305(b)(1) distribution should be viewed as economically equivalent to (i) the distribution of cash or other property to the distributee shareholders, followed by (ii) the use of that cash or other property by some distributee shareholders to purchase stock from the covered corporation.

According to the stakeholders, the use of cash or other property by some distributee shareholders to purchase stock from the covered corporation in a section 305(b)(1) distribution presumably would be treated as an issuance for purposes of the netting rule. Therefore, the stakeholders concluded that stock issued in a section 305(b)(1) distribution should not be disregarded solely because the covered corporation does not receive money or services in exchange for that stock.

As reflected in section 3.08(4)(b) of Notice 2023–2, the Treasury Department and the IRS are of the view that distributions by a covered corporation of its own stock should not be taken into account for purposes of the netting rule, regardless of whether the distributions are taxable to the covered corporation's shareholders under section 305(b). Although the recipients of stock distributions under section 305(a) and (b) are subject to different Federal income tax consequences, the Treasury Department and the IRS are of the view that this distinction should not affect the application of the stock repurchase excise tax because the statutory language of section 4501(c)(3) does not focus on treatment of shareholders. Therefore, the Treasury Department and IRS are of the view that disparate treatment should not be provided under the netting rule for different types of section 305 distributions.

For the foregoing reasons, and to facilitate the ability for the IRS to administer and enforce the stock repurchase excise tax, the proposed regulations would not accept the stakeholders' recommendation. Instead, distributions by a covered corporation of its own stock would not be taken into account for purposes of the netting rule. *See* proposed § 58.4501–4(f)(1).

5. Stock-for-Stock Exchanges

A stakeholder recommended that stock issued in an E reorganization should not be treated as an issuance for purposes of the netting rule. For support, the stakeholder contended that the proposed regulations should preclude covered corporations from avoiding the stock repurchase excise tax by engaging in transactions with no meaningful dilutive effect on the corporation's equity capital. In other words, the stakeholder presented the same rationale as the stakeholder's rationale for recommending that stock issued in a distribution to which section 305(a) applies should not be treated as an issuance for purposes of the netting rule. For similar reasons, the stakeholder also recommended that stock issued in an exchange under section 1036 of the Code should not be treated as an issuance for purposes of the netting rule.

The Treasury Department and the IRS continue to be of the view that stock issued in an E reorganization should not be treated as an issuance for purposes of the netting rule because such stock already is taken into account under the reorganization exception. Under that exception (*see* section 3.07(2) of Notice 2023–2 and the discussion in part X.A of this Explanation of Provisions), the fair market value of stock repurchased by the covered corporation in an E reorganization using qualifying property is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base. Therefore, if the issuance of such qualifying property were treated as an issuance for purposes of the netting rule, the covered corporation's stock repurchase excise tax base would be reduced twice as a result of a single stock issuance. The proposed regulations reflect this view. *See* proposed § 58.4501–4(f)(3); *see also* part XI.C.2 of this Explanation of Provisions (discussion of no double benefit rule).

Similarly, the Treasury Department and the IRS agree with the stakeholder that stock issued in a section 1036 exchange should not be treated as an issuance for purposes of the netting rule. Accordingly, the proposed regulations would provide that stock issued in a section 1036 exchange is not treated as an issuance for purposes of the netting rule. *See* proposed § 58.4501–4(f)(8).

6. Issuances in F Reorganizations

A stakeholder recommended that stock issued in an F reorganization should not be treated as an issuance for purposes of the netting rule. The Treasury Department and the IRS continue to be of the view that stock issued in an F reorganization should not be treated as an issuance for purposes of the netting rule because that stock already is taken into account to reduce the covered corporation's stock repurchase excise tax base under the reorganization exception. Therefore, if the issuance of such qualifying property were treated as an issuance for purposes of the netting rule, the covered corporation's stock repurchase excise tax base would be reduced twice as a result of a single stock issuance. The proposed regulations reflect this view. *See* proposed § 58.4501–4(f)(3); *see also* part XI.C.2 of this Explanation of Provisions (discussion of no double benefit rule).

In addition, the proposed regulations would articulate explicitly the view of the Treasury Department and the IRS that F reorganizations should be treated for stock repurchase excise tax purposes in the same manner in which they are treated under the Code and Treasury regulations. In particular, the proposed regulations would reflect the view of the Treasury Department and the IRS that, for purposes of the netting rule, the transferor corporation and the resulting corporation in an F reorganization should be treated as the same corporation. *See* § 1.381(b)–1(a)(2) (providing that, in the case of a transaction qualifying as an F reorganization, the acquiring

corporation is treated just as the transferor corporation would have been treated had there been no reorganization). As a result, the transferor corporation's issuances in the portion of the taxable year preceding an F reorganization may offset the resulting corporation's repurchases in the portion of the taxable year following the F reorganization. Likewise, the resulting corporation's issuances in the portion of the taxable year following an F reorganization may offset the transferor corporation's repurchases in the portion of the taxable year preceding the F reorganization. *See* proposed § 58.4501–4(b)(4).

7. Issuances by a Dealer in Securities

Under section 3.08(4)(g) of Notice 2023–2, any stock issued by a covered corporation that is a dealer in securities is not treated as issued to the extent the stock is issued, or otherwise is used to satisfy obligations to customers arising, in the ordinary course of the dealer's business of dealing in securities. No feedback was received on the treatment described in Notice 2023–2 of issuances by a dealer in securities, and the proposed regulations would retain the approach described in Notice 2023–2. *See* proposed § 58.4501–4(f)(6).

8. Amounts Excluded Under the Stock Contribution Exception

Covered corporation stock contributed to or purchased by an employer-sponsored retirement plan is not treated as issued or provided for purposes of the netting rule. *See* part XI.G.3 of this Explanation of Provisions for further discussion.

9. Instruments Not in the Legal Form of Stock

Because taxpayers generally can choose the form of the instruments that they issue, the Treasury Department and the IRS are concerned that allowing taxpayers to immediately offset their current repurchases by issuing instruments not in the legal form of stock that are treated as stock for Federal income tax purposes at issuance (non-stock instruments) may create the potential for abuse. For example, a taxpayer seeking to avoid the application of the stock repurchase excise tax might issue deep-in-the-money call options, which the taxpayer takes the position are treated as stock for Federal income tax purposes, to accommodation parties with the mutual understanding that such options would never be exercised. While a taxpayer could in principle similarly issue stock to an accommodation party in order to reduce its stock repurchase excise tax base, the issuance of stock by a publicly traded corporation is subject to legal, regulatory, and practical restrictions that do not or may not apply to an instrument that is not in the legal form of stock. In such a case, respecting the issuance of the option as an issuance of stock at the time of issuance for purposes of the netting rule could allow taxpayers to unduly reduce their stock repurchase excise tax liability.

Accordingly, pursuant to section 4501(f), the proposed regulations provide an anti-avoidance rule to address this concern. Under proposed § 58.4501–4(f)(13), the issuance of a non-stock instrument, including certain deep-in-the money options, would not be treated as an issuance of stock for purposes of the netting rule until the instrument is repurchased, and that the amount of the issuance under the netting rule would be limited to the lesser of the fair market value of the non-stock instrument at the time of its issuance or repurchase. The taxpayer would be entitled to regard the issuance for purposes of the netting rule for the repurchased non-stock instrument only if it timely reports the repurchase as a repurchase of a non-stock instrument. In order to prevent taxpayers from taking inconsistent positions with respect to comparable non-stock instruments, a taxpayer that fails to timely report a repurchase of a non-stock instrument as such will not be entitled to regard any issuances for purposes of the netting rule for comparable non-stock instruments repurchased within the five taxable years ending on the last day of the repurchase year, unless the failure to timely report the earlier repurchase was due to reasonable cause. *See* proposed § 58.4501–4(f)(13)(ii)(D). Under the proposed regulations, a comparable non-stock instrument is a non-stock instrument that has substantially similar economic terms as the repurchased non-stock instrument, regardless of whether the comparable non-stock instrument and the repurchased non-stock instrument have the same legal form. *See id.*

Notwithstanding the rules described above for issuances, the Treasury Department and IRS are of the view that the repurchase of an instrument that meets the definition of stock at issuance should be treated as a repurchase, regardless of the legal form of such instrument. Given the potential for abuses of the netting rule involving non-stock instruments, the Treasury Department and the IRS are of the view that the different treatment for non-stock instruments under the netting rule as compared to the rule for repurchases is justified because a taxpayer generally can control whether to issue a particular instrument in the form of stock.

D. Carryovers and Carrybacks of Issuances of Preferred Stock

Several stakeholders raised concerns regarding regulated financial institutions that issue additional tier 1 preferred stock to comply with regulatory requirements. In particular, stakeholders noted that, although regulated financial institutions often must replace redeemed additional tier 1 preferred stock with new additional tier 1 preferred stock, timing considerations and the regulatory approval process often prevents such issuances from occurring during the same taxable year as the repurchases. As a result, regulated financial institutions may not be able to match their redemptions of additional tier 1 preferred stock with their issuances of replacement additional tier 1 preferred stock under the netting rule.

The stakeholders recommended that the proposed regulations permit covered corporations to carry forward or carry back for one taxable year the aggregate amount of issuances by the covered corporation of additional tier 1 preferred stock that exceed the aggregate amount of repurchases of additional tier 1 preferred stock by that covered corporation for a taxable year. One stakeholder suggested that the proposed regulations incorporate such a carryforward and carryback rule for all types of preferred stock.

The Treasury Department and the IRS are of the view that the stakeholder's recommended carryforward and carryback provision is inconsistent with the plain language of the statute. Section 4501 provides clearly that the stock repurchase excise tax must be determined for a covered corporation on a taxable-year-by-taxable-year basis, and the amount of repurchases for a taxable year may be adjusted solely to take into account issuances by the covered corporation during that same taxable year. *See* section 4501(a) (imposing the stock repurchase excise tax on ''stock of the corporation which is repurchased by such corporation during the taxable year''); section 4501(c)(3) (reducing the amount of repurchases for a taxable year ''by the fair market value of any stock issued by the covered corporation during the taxable year''). In this regard, under section 3.03(3)(c) of Notice 2023–2, any reductions in the stock repurchase excise tax base under the statutory exceptions or the netting rule in excess of the aggregate fair market value of all repurchases during the taxable year are not carried forward or backward to preceding or succeeding

taxable years of the covered corporation. Accordingly, the proposed regulations would not adopt this recommendation.

E. Fair Market Value of Shares Issued Pursuant to the Conversion of a Convertible Debt Instrument

A stakeholder recommended that, for purposes of the netting rule, the fair market value of shares issued pursuant to the conversion of a convertible debt instrument should be the market price of the shares on the date of issuance, rather than the consideration actually paid by the holder to acquire the instrument. The stakeholder recommended this approach based in part on the plain language of section 4501(c)(3), which refers to ''the *fair market value* of any stock issued by the covered corporation during the taxable year'' (*emphasis added*).

The Treasury Department and the IRS agree with the stakeholder. Consistent with section 3.08(5) of Notice 2023–2, the Treasury Department and the IRS are of the view that, for purposes of the netting rule, the fair market value of stock issued generally should be the market price of the stock on the date the stock is issued. *See* proposed § 58.4501–4(e)(1). Although the proposed regulations do not expressly address stock issued upon the conversion of a convertible debt instrument, such stock would fall within the scope of this general rule. For special rules for valuing stock issued or provided to an employee or other service provider in connection with the performance of services, *see* proposed § 58.4501–4(e)(5) and part XI.G.7 of this Explanation of Provisions.

F. Net Share Settlement

A stakeholder noted that, if stock is transferred in connection with the performance of services, an employer may withhold some of the stock to cover the exercise price, tax withholding obligations, or other withholding obligations. The stakeholder noted that the stock withheld could be viewed either as transferred to the service provider and then repurchased by the covered corporation, or as never having been issued.

Under section 3.08(3)(a)(ii) of Notice 2023–2, stock withheld by a covered corporation or a specified affiliate to satisfy an employer's income tax withholding obligation described in section 3402 of the Code, or an employer's employment tax withholding obligation described in section 3102 of the Code, is not treated as stock issued or provided to an employee by the covered corporation or specified affiliate. Under section 3.08(3)(a)(iii) of Notice 2023–2, stock withheld by a covered corporation or a specified affiliate to satisfy the exercise price of a stock option also is not treated as stock issued or provided by the covered corporation or specified affiliate to an employee.

As reflected in section 3.08(3)(a)(ii) and (iii) of Notice 2023–2, the Treasury Department and IRS are of the view that stock withheld to satisfy an employer's withholding obligation under section 3102 or 3402, or to satisfy the exercise price of a stock option, is not issued or provided by the covered corporation or a specified affiliate. This position is consistent with the section 83 rules.

Stakeholders noted that stock is withheld in other situations (such as State or foreign tax withholding) and requested clarification on whether those situations also would not result in the issuance or provision of stock. To provide greater clarity regarding the treatment of net share settlements, these proposed regulations would expand Notice 2023–2 to cover all situations involving net share settlements. Accordingly, the proposed regulations would provide that stock withheld by the covered corporation or specified affiliate to satisfy the exercise price of a stock option or to cover any withholding obligation is not treated as issued or provided under the netting rule. *See* proposed § 58.4501–4(f)(11).

A similar result would apply to the delivery of stock under an option not issued in connection with the performance of services, including pursuant to an option embedded in a convertible bond. *See* part XIV.B of this Explanation of Provisions (discussion of the treatment of cash paid in lieu of a fractional share).

G. Special Rules for Stock Issued or Provided to Service Providers

1. Issuances to Service Providers Other Than Employees

Stakeholders requested clarification that the netting rule applies to a covered corporation's issuances of its stock to service providers other than employees. The Treasury Department and the IRS agree that the same rules for determining whether covered corporation stock is issued, the amount of stock issued, and the timing of an issuance should apply to both employee and non-employee service providers of a covered corporation for purposes of the netting rule. The Treasury Department and the IRS are of the view that applying the same rules to all compensatory stock transfers by a covered corporation would improve administrability of the stock repurchase excise tax because the timing and value of stock issued or provided in connection with the performance of services is determined under section 83 for both employee and non-employee service providers.

Accordingly, these proposed regulations would clarify that the netting rule applies to issuances by a covered corporation to both employee and non-employee service providers of the covered corporation. *See* proposed § 58.4501–4(b)(1)(i). However, as discussed in part XI.G.2 of this Explanation of Provisions, covered corporation stock provided by a specified affiliate in connection with the performance of services by a non-employee of the specified affiliate would not qualify for the netting rule.

2. Meaning of Stock ''Issued or Provided'' in Section 4501(c)(3)

A stakeholder noted that section 4501 neither defines the term ''provided'' nor explains the distinction between the terms ''issued'' and ''provided'' in section 4501(c)(3). The stakeholder suggested that one way the distinction between these terms could be explained is by construing stock ''issued'' to mean a transfer of newly issued stock, and stock ''provided'' to mean a transfer of treasury shares. However, the stakeholder recommended against this interpretation because there is no policy reason for treating newly issued shares and treasury shares differently. As discussed in part XI.B of this Explanation of Provisions, the Treasury Department and IRS are of the view that newly issued shares and treasury shares should be treated the same way for purposes of the netting rule. *See* proposed § 58.4501–1(b)(29).

Instead, the stakeholder recommended that stock ''issued'' should be interpreted to mean covered corporation stock issued directly by the covered corporation to its employees or other service providers. In contrast, stock ''provided'' should be interpreted to mean covered corporation stock transferred by a specified affiliate (which cannot issue covered corporation stock) to its employees.

The Treasury Department and IRS agree with the foregoing interpretation. A specified affiliate may provide stock in the covered corporation, rather than the specified affiliate's own stock, as compensation for services provided by the specified affiliate's employees. Thus, this interpretation would not interfere with existing stock-based compensation arrangements. Moreover, because section 4501(c)(3) applies to transfers by a specified affiliate to its employees, stock provided by the

specified affiliate in connection with the performance of services by its employees (but not by its non-employee service providers) would qualify for the netting rule under these proposed regulations.

Under § 1.83–6(d), if a covered corporation transfers its stock in connection with the performance of services for a specified affiliate, then (i) the covered corporation is treated as having contributed the stock to the capital of the specified affiliate, and (ii) the specified affiliate is treated as immediately transferring the covered corporation stock to the service provider. Thus, under the proposed regulations, if the transfer is to an employee of the specified affiliate in connection with the performance of services for the specified affiliate, the specified affiliate would be treated as transferring the stock to an employee in connection with the performance of services for the specified affiliate and the transfer would be regarded for purposes of the netting rule. *See* proposed § 58.4501–4(f)(2)(iv).

3. Amounts Excluded Under the Stock Contribution Exception

A stakeholder noted that section 4501 does not explicitly preclude a covered corporation from reducing the amount of its stock repurchase excise tax under the netting rule using repurchased stock that was excluded from the stock repurchase excise tax under the statutory exception for contributions to employer-sponsored retirement plans. *See* section 4501(e)(2) and the discussion in part X.B of this Explanation of Provisions. The stakeholder requested clarification that stock that is excluded from the stock repurchase excise tax under the stock contribution exception may not then be used to reduce the stock repurchase excise tax base under the netting rule.

The Treasury Department and the IRS agree that permitting an offset against the stock repurchase excise tax base under both the stock contribution exception and the netting rule would be inconsistent with the statute. Further, stock contributed to or purchased by an employer-sponsored retirement plan is issued or provided to the plan, not a service provider. Thus, consistent with section 3.07(3)(e) of Notice 2023–2, these proposed regulations would provide that stock contributed to or purchased by an employer-sponsored retirement plan does not reduce the stock repurchase excise tax base under the netting rule. *See* proposed § 58.4501–4(f)(10).

4. Net Share Settlement of Options Issued in Connection With the Performance of Services

A stakeholder requested guidance explaining how to determine the amount of the offset under the netting rule for options settled in stock. The stakeholder recommended that, if an option is ''in the money'' (that is, if the exercise price is less than the fair market value of the stock on the date of exercise), then the stock repurchase excise tax base should be reduced by the full fair market value of the stock, and not merely the exercise price.

The Treasury Department and the IRS agree with the stakeholder. The Treasury Department and the IRS are of the view that, for purposes of the stock repurchase excise tax, the net share settlement of options issued in connection with the performance of services should be treated in the same manner as the settlement of other options issued in connection with the performance of services. *See* proposed § 58.4501–4(e)(5) and (f)(11).

5. ''Sell to Cover'' Arrangements

A stakeholder described a ''sell to cover'' arrangement for stock-based compensation as a transaction in which a third party (usually a broker) facilitates the issuance of stock-based compensation by providing amounts necessary to cover a withholding obligation (for example, to cover Federal income taxes that must be withheld on the transferred shares). The stakeholder suggested that this transaction should be treated as an issuance or provision of stock for purposes of the netting rule.

The Treasury Department and the IRS agree with the stakeholder. In these arrangements, stock is issued or provided to the service provider, or to a third party on behalf of the service provider, and then immediately sold to cover a withholding obligation, and the fair market value of the amounts necessary to cover the withholding obligation is included in the service provider's gross income under section 83. Therefore, as reflected in section 3.08(3)(a)(iv) of Notice 2023–2, these proposed regulations would provide that stock transferred in these arrangements is treated as issued or provided for purposes of the netting rule. *See* proposed § 58.4501–4(c)(2).

6. Time When Stock Is Considered Issued or Provided to an Employee or Other Service Provider

a. In General

Consistent with section 3.08(3)(b)(i) of Notice 2023–2, these proposed regulations would provide that stock is treated as issued or provided to an employee or other service provider when beneficial ownership transfers for tax purposes. *See* proposed § 58.4501–4(d)(2). Beneficial ownership ordinarily transfers when the service recipient initiates the transfer or when the stock is vested. However, if the service provider makes a valid election under section 83(b), beneficial ownership transfers on the date the property was transferred. *See* section 83. Stock transferred to a grantor trust (for example, a Rabbi trust) is not treated as issued or provided until beneficial ownership transfers to the service provider for tax purposes.

b. Restricted Stock

Several stakeholders requested clarification as to when restricted stock is treated as issued for purposes of the netting rule. The stakeholders recommended treating restricted stock as issued when the stock is treated as beneficially owned under the section 83 rules. Thus, such stock would be treated as issued only if and when the shares become substantially vested, unless the recipient makes a section 83(b) election with respect to the shares.

The Treasury Department and the IRS agree that restricted stock should be treated as issued for purposes of the netting rule when the service provider recipient of the stock is treated as the beneficial owner for Federal income tax purposes under the section 83 rules. Under section 3.08(3)(b)(i) of Notice 2023–2, stock is issued or provided by a covered corporation or a specified affiliate to an employee as of the date the employee is treated as the beneficial owner of the stock for Federal income tax purposes, and that an employee generally is treated as the beneficial owner of the stock when the stock is transferred by the covered corporation (or the specified affiliate) to the employee and the stock is substantially vested within the meaning of § 1.83–1(b). Thus, stock transferred pursuant to a vested stock award or restricted stock unit is issued or provided when the covered corporation or specified affiliate initiates payment of the stock. *See* section 3.08(3)(b)(i) of Notice 2023–2.

Stock that is not substantially vested within the meaning of § 1.83–3(b) generally is not issued or provided to the employee until the employee vests in the stock, unless the employee makes a valid election under section 83(b), in which case the stock is treated as issued or provided to the employee as of the transfer date. *See* sections 3.08(3)(b)(i) and (iii) of Notice 2023–2. Stock transferred to an employee pursuant to an option described in § 1.83–7 or

section 421 or a stock appreciation right is issued or provided to the employee as of the date the employee exercises the option or stock appreciation right. *See* section 3.08(3)(b)(ii) of Notice 2023–2.

Consistent with section 3.08(3)(b)(i) of Notice 2023–2, the proposed regulations would provide that stock that is not substantially vested within the meaning of § 1.83–3(b) generally is not treated as issued or provided to the employee until the stock vests. *See* proposed § 58.4501–4(d)(2)(i). However, if the employee makes a valid election under section 83(b), the stock would be treated as issued or provided to the employee as of the transfer date. *See* proposed § 58.4501–4(d)(2)(iii).

Alternatively, one stakeholder recommended treating restricted stock as issued at the time the award is granted (that is, when the stock is treated as outstanding for securities law purposes). However, the Treasury Department and the IRS are of the view that applying the section 83 rules to determine when restricted stock is treated as issued is appropriate, and that applying the section 83 rules consistently would decrease the compliance burden on taxpayers and the administrative burdens on the IRS. Accordingly, the proposed regulations would not adopt this alternative recommendation.

7. Valuing Stock Issued or Provided to an Employee or Other Service Provider

A stakeholder requested guidance on how to determine the fair market value of stock issued or provided to an employee for purposes of the netting rule. The stakeholder recommended using the market price on the date of the issuance or provision, with specific rules to determine fair market value for certain kinds of stock.

The Treasury Department and IRS generally agree with the stakeholder. Consistent with section 3.08(3)(c) of Notice 2023–2, these proposed regulations would cross-reference the section 83 rules to determine the fair market value of stock issued or provided to an employee or other service provider under the netting rule. *See* proposed § 58.4501–4(e)(5). Under the section 83 rules, the fair market value of the stock is determined as of the date that beneficial ownership transfers to the service provider.

The Treasury Department and the IRS are of the view that applying the section 83 valuation rules should reduce the compliance burden on taxpayers and the administrative burden on the IRS, as taxpayers also apply the section 83 rules for other tax purposes. Under the proposed regulations, the section 83 valuation rules also would apply if the covered corporation or specified affiliate issues or provides stock pursuant to the service provider exercising an option (including an option described in section 421) or making a valid section 83(b) election on restricted stock. *See* proposed § 58.4501–4(e)(5).

A stakeholder also requested clarification on valuing stock that is not included in United States income, such as stock issued to a non-resident employee who provides services outside the United States. The proposed regulations would provide that, under the netting rule, the fair market value of stock is determined under the section 83 rules, regardless of whether the income inclusion is governed by section 83. Thus, for example, the fair market value of stock issued pursuant to a stock option described in section 421 and stock issued to a non-resident alien for services performed outside the United States is determined using the section 83 rules. *See* proposed § 58.4501–4(e)(5).

XII. Mergers and Acquisitions With Post-Closing Price Adjustments

A. Overview

A stakeholder provided recommendations regarding post-closing price adjustments in M&A transactions. This stakeholder explained that adjustments may include additional payments to the target corporation's shareholders based on achievement by the target corporation's business of certain milestones or fluctuations in value of the acquiring corporation's stock (earnout), or the forfeiture of consideration by the target corporation's shareholders to compensate the acquiring corporation for breaches of representations and warranties or for other indemnification obligations (indemnification payment).

This stakeholder also noted that consideration provided at closing in a tax-free reorganization may include shares that are issued as part of an earnout (earnout shares) or that are subject to forfeiture to satisfy indemnification obligations. Alternatively, the acquiring corporation may have a right to repurchase certain shares for a price that is below the stock's fair market value (below-market repurchase). Despite being subject to forfeiture or a below-market repurchase, the stakeholder explained that such shares potentially could be treated as owned by the former target corporation shareholders for Federal income tax purposes at the time of issuance.

B. When Shares Issued as Part of an Earnout or Potentially Subject to an Indemnification Payment Are Treated as Issued

The stakeholder recommended that shares issued by an acquiring corporation should be treated as issued for purposes of the netting rule regardless of whether those shares are subject to forfeiture or a below-market repurchase. Essentially, the stakeholder recommended that the proposed regulations should permit an acquiring corporation to offset the fair market value of that corporation's repurchases during the taxable year by the fair market value of all shares issued by that corporation in an M&A transaction during that taxable year if those shares are treated as issued for Federal income tax purposes.

The Treasury Department continue to be of the view that stock should be treated as issued when ownership of the stock transfers to the recipient for Federal income tax purposes. *See* section 3.08(2) of Notice 2023–2. This treatment is consistent with the stakeholder's recommendation, and therefore the Treasury Department and the IRS have provided no special rule in the proposed regulations. *See* proposed § 58.4501–4(d)(1); *see also* part III.B.1 of this Explanation of Provisions (discussion of timing of issuances and repurchases).

C. Fair Market Value of Shares Issued as Part of an Earnout or Potentially Subject to an Indemnification Payment

A stakeholder recommended that, for purposes of the netting rule, the fair market value of shares that potentially are subject to forfeiture or a below-market repurchase should be the trading price of such shares on the date of issuance (rather than on the date of forfeiture or repurchase). For support, the stakeholder contended that (i) the parties generally do not expect the acquiring corporation to make significant claims for indemnification payments, and (ii) discounting the fair market value to reflect the likelihood of forfeiture or a below-market repurchase would be administratively cumbersome for the IRS and taxpayers.

Although Notice 2023–2 does not expressly address this issue, it does reflect the stakeholder's recommendation. Under Notice 2023–2, if the shares were not disregarded under the no double benefit rule, the fair market value of the shares would be determined using their market price on the date of issuance, consistent with the stakeholder's recommendation regarding the treatment of shares

potentially subject to an indemnification payment. The proposed regulations would maintain this treatment and would not include special rules to determine the fair market value of such shares.

In contrast, the stakeholder also recommended that the fair market value of earnout shares should be discounted to reflect the present value and likelihood of payment. The Treasury Department and the IRS are of the view that incorporation of the stakeholder's recommendation into the proposed regulations would introduce uncertainty and complexity into stock valuation for purposes of the netting rule. Furthermore, the stakeholder's recommendation would be inconsistent with the statutory language of section 4501(c)(3), which simply references the ''fair market value'' of stock issued or provided. As a result, the proposed regulations would not include special rules to determine the fair market value of earnout shares.

D. Forfeiture of Shares Received as Part of an Earnout or Potentially Subject to an Indemnification Payment

One stakeholder generally recommended that the forfeiture of earnout shares should not be treated as a repurchase. The stakeholder asserted that such a forfeiture would not constitute a section 317(b) redemption because the corporation would have exchanged no property for the earnout shares. Similarly, the stakeholder also contended that the forfeiture should not be treated as an economically similar transaction because no capital would have left the corporation.

In contrast, the stakeholder recommended that the forfeiture of earnout shares as part of an indemnification payment should be treated as a repurchase of those shares, because the target corporation's former shareholders would have economically benefited from the forfeiture by not needing to use cash or other property to make the indemnification payment. Therefore, in the stakeholder's view, the acquiring corporation should be treated as repurchasing the shares in an amount equal to the value of the indemnification claim, as determined based on the documents governing the transaction.

Under Notice 2023–2, a forfeiture of shares would not be treated as a repurchase, because the forfeiture is neither a section 317(b) redemption nor treated as an economically similar transaction. However, there would be an issuance for purposes of the netting rule when ownership of those shares transfers to the recipient for Federal income tax purposes, even though those shares potentially are still subject to forfeiture.

For the same reasons discussed in part II.D of this Explanation of Provisions, the Treasury Department and the IRS are of the view that a forfeiture of shares should count as a repurchase if an issuance of such shares would be counted under the netting rule (in other words, those shares should be treated consistently for purposes of repurchases and issuances). Consequently, because the issuance of earnout shares or shares subject to an indemnification payment would be taken into account for purposes of the netting rule when those shares transfer to the recipient for Federal income tax purposes, the proposed regulations would treat the forfeiture of those shares as a repurchase at the time of forfeiture. *See* proposed § 58.4501–2(e)(4)(vi). To facilitate the ability for the IRS to administer and enforce the stock repurchase excise tax, the amount of the repurchase would equal the market price of the forfeited stock on the date of forfeiture under the general rule in proposed § 58.4501–2(h)(1) and would not be determined by the underlying transaction documents.

E. Below-Market Repurchase of Shares Received as Part of an Earnout or Potentially Subject to an Indemnification Payment

A stakeholder recommended that, if the acquiring corporation repurchases earnout shares in a below-market repurchase, only the amount paid should be reflected in the acquiring corporation's stock repurchase excise tax base. According to the stakeholder, proposed regulations adopting that approach would be appropriate because the negotiated price of the earnout shares would reflect the restrictions applicable to those shares and the circumstances in which that stock is repurchased. In contrast, the market price of those earnout shares would reflect an inaccurate price—that is, the market price would fail to reflect the same restrictions to which the earnout shares would be subject.

The Treasury Department and the IRS continue to be of the view that the fair market value of stock issued by a covered corporation should be the market price on the date of issuance. *See* section 3.08(5) of Notice 2023–2. The Treasury Department and the IRS incorporated this position in Notice 2023–2 to reduce unnecessary complexity for taxpayers and facilitate the ability for the IRS to administer and enforce the stock repurchase excise tax. In addition, the Treasury Department and the IRS observe that the approach described in Notice 2023–2 ensures that repurchases and issuances would be valued based on identical methodologies, thereby ensuring symmetrical treatment. Accordingly, the proposed regulations would adopt the approach described in Notice 2023–2, including with regard to stock that is subject to a below-market repurchase.

XIII. Troubled Companies

In section 6.02(3) of Notice 2023–2, the Treasury Department and the IRS requested comments on whether special rules should be provided for bankrupt or troubled companies. For example, the Treasury Department and the IRS asked whether a section 317(b) redemption occurring as part of a restructuring of a bankrupt or troubled company should be excluded from the definition of ''repurchase.''

One stakeholder recommended that troubled companies generally should not be subject to the stock repurchase excise tax. According to the stakeholder, application of the stock repurchase excise tax would further burden troubled companies and would provide troubled companies with an incremental incentive to reject otherwise equitable restructuring plans to the extent those plans would implicate the stock repurchase excise tax. The stakeholder recommended that an exemption apply to exchanges of equity for other property by a corporation that either is in a title 11 case or is insolvent (within the meaning of section 108(d)(3) of the Code) immediately prior to the exchange. The stakeholder further recommended that the proposed regulations confirm that the stock repurchase excise tax does not apply to acquisitive reorganizations under section 368(a)(1)(G) (acquisitive G reorganizations) and exchanges of distressed debt.

In contrast, another stakeholder recommended that no special rules be provided for troubled companies, other than a modification of the valuation rule for repurchases occurring as part of a restructuring. The stakeholder also recommended that the definition of ''acquisitive reorganization'' include acquisitive G reorganizations. According to the stakeholder, if a troubled company distributes value to existing shareholders, there is no reason to exempt such a distribution from the stock repurchase excise tax if the distribution otherwise is a repurchase within the scope of the stock repurchase excise tax. The stakeholder also stated that, in most situations, the value of stock issued to creditors in exchange for their claims will significantly exceed

the value of any recovery received by existing shareholders, such that the netting rule would prevent any stock repurchase excise tax from being owed.

With respect to the valuation rule for repurchases, the stakeholder stated that the general rule for valuing repurchased stock (by reference to the ''market price'' of repurchased stock) could lead to inappropriate outcomes for troubled companies undergoing a restructuring. According to the stakeholder, the recovery amount received by a shareholder in exchange for its stock may be significantly less than the market price of the stock determined immediately after such repurchase. For support, the stakeholder asserted that the recovery amount will be determined when the stock is worth very little, but the market price (if determined immediately after the restructuring) may be much higher.

The Treasury Department and the IRS are of the view that special rules for troubled companies are neither necessary nor appropriate to carry out the purposes of the stock repurchase excise tax. In reaching this view, the Treasury Department and the IRS observe that a troubled company generally would not be treated as repurchasing its stock in either a title 11 restructuring or an out-of-court debt restructuring. In each type of transaction, it is the understanding of the Treasury Department and the IRS that the troubled company's stock typically would be cancelled solely as a result of the title 11 restructuring or the out-of-court debt restructuring, rather than as any redemption or repurchase. Accordingly, such cancellation would not constitute a redemption within the meaning of section 317(b). *See* section 317(b) (defining a redemption as a corporation's acquisition of its stock from a shareholder in exchange for ''property'' (within the meaning of section 317(a))). For the same reason, the Treasury Department and the IRS are of the view that such a transaction should not constitute an economically similar transaction under the proposed regulations. *See* proposed § 58.4501–2(e)(4).

The Treasury Department and the IRS agree that the definition of an ''acquisitive reorganization'' should include acquisitive G reorganizations. *See* part VIII.A of this Explanation of Provisions (discussion of acquisitive reorganizations). The Treasury Department and the IRS are of the view that an exchange between a target corporation and its shareholders pursuant to an acquisitive G reorganization should be subject to the stock repurchase excise tax to the same extent as in other acquisitive reorganizations. That is, a stock repurchase excise tax liability should arise from an exchange in an acquisitive G reorganization to the extent the target corporation shareholders exchange their target corporation stock for non-qualifying property. Accordingly, the proposed regulations would include acquisitive G reorganizations in the definition of ''acquisitive reorganization.'' *See* proposed § 58.4501–1(b)(1).

XIV. Additional Miscellaneous Issues

A. Ordering Rule for Statutory Exceptions and Netting Rule

1. Overview

Stakeholders requested a rule to clarify the order in which taxpayers should apply the de minimis exception, the other statutory exceptions, the netting rule, and any other exceptions set forth in regulations. Under Notice 2023–2, a covered corporation computes its stock repurchase excise tax base for a taxable year by (i) determining the aggregate fair market value of all repurchases, (ii) reducing that amount to the extent any statutory exceptions apply, and then (iii) reducing that amount under the netting rule. The determination whether the de minimis exception applies is made before applying any statutory exceptions or adjustments under the netting rule (that is, after step (i)).

One stakeholder recommended an approach involving the following steps. First, a taxpayer should compute its gross repurchases for the taxable year, taking into account any exclusions from the definitions of ''stock'' and ''repurchase.'' Second, the taxpayer should determine whether the de minimis exception applies. (If so, no further computations would be necessary.) Third, the taxpayer should apply the other statutory exceptions to reduce the amount computed in the first step. Finally, the taxpayer should apply the netting rule to the amount computed in the third step, thereby arriving at the net repurchase amount subject to the stock repurchase excise tax.

The stakeholder's recommendation generally is consistent with section 3.03(3)(a) of Notice 2023–2. The proposed regulations would maintain the ordering rules described in Notice 2023–2. *See* proposed § 58.4501–2(c)(1).

2. Section 4501(e)

One stakeholder contended that the plain meaning of the lead-in language in section 4501(e)—which states that ''Subsection (a) shall not apply'' in the situations described in section 4501(e)(1) through (6)—is that an amount excluded under one of these statutory exceptions should not first be treated as part of a share repurchase. In other words, the stakeholder interpreted that lead-in language to provide that taxpayers should not be required to include all repurchases in the stock repurchase excise tax base and then reduce the amount of that base by the amount of those repurchases that qualify for a statutory exception.

The Treasury Department and the IRS are of the view that the lead-in language in section 4501(e) does not affect the definition of ''repurchase'' under section 4501(c) (in other words, that lead-in language applies solely to section 4501(a)). The lead-in language in section 4501(e) states that section 4501(a), which imposes a one percent excise tax on repurchases, does not apply in certain specified situations. The lead-in language in section 4501(e) does not state that those specified situations are not ''repurchases'' within the meaning of section 4501(c). Indeed, each of the statutory exceptions in section 4501(e) expressly involves a repurchase. *See,* for example, section 4501(e)(1) (''to the extent that *the repurchase* is part of a reorganization. . .'') and (6) (''to the extent that *the repurchase* is treated as a dividend. . .'') (*emphasis added*). Therefore, the Treasury Department and the IRS are of the view that Notice 2023–2 properly implements the lead-in language in section 4501(e), and the proposed regulations would not incorporate the stakeholder's recommendation.

3. De Minimis Rule

Several stakeholders objected to the approach described in Notice 2023–2 that the determination of whether the de minimis exception applies be made before the application of any other statutory exceptions or adjustments under the netting rule. One stakeholder contended that this approach imposes a compliance burden by requiring taxpayers to consider the application of the stock repurchase excise tax whenever taxpayers engage in a transaction that may involve a deemed exchange of stock. Stakeholders also contended that this approach would have the effect of eliminating the de minimis exception or rendering its application arbitrary in certain circumstances.

For example, one stakeholder noted that, if a covered corporation repurchases $2 million of its stock and contributes $1.5 million of that stock to an ESOP, the incidence of the stock repurchase excise tax would depend on

the order in which the statutory exceptions are applied. If the de minimis exception were to be applied before the stock contribution exception, the stock repurchase excise tax would be imposed on $0.5 million. Conversely, if the de minimis exception were to be applied after the stock contribution exception, then the stock repurchase excise tax would not apply at all because the corporation's $0.5 million of repurchases would not exceed the $1 million de minimis threshold.

As another example, the stakeholder assumed that a covered corporation changes the par value of its stock with a fair market value of $1 billion. For Federal income tax purposes, the change in par value would be treated as an E reorganization in which the corporation's shareholders are deemed to exchange their old stock for newly issued stock. The stakeholder noted that, under the approach described in Notice 2023–2, (i) this exchange would be included in the stock repurchase excise tax base computation as a $1 billion repurchase, and (ii) although this amount wholly would be offset under the reorganization exception, the inclusion of the transaction in the stock repurchase excise tax base would completely exhaust the allowance under the de minimis exception.

The Treasury Department and the IRS are of the view that applying the de minimis exception before the other statutory exceptions is consistent with the statutory language and structure of section 4501. By its terms, the de minimis exception applies ''in any case in which the total value of the stock *repurchased* during the taxable year does not exceed $1,000,000 . . .'' (*emphasis added*). The determination of whether a transaction is a repurchase under section 4501(c) is independent of the statutory exceptions in section 4501(e). Therefore, the Treasury Department and the IRS are of the view that the de minimis exception should be measured against a covered corporation's gross repurchases (that is, a covered corporation's repurchases before reduction under another statutory exception or the netting rule).

The proposed regulations would provide that a covered corporation would compute its stock repurchase excise tax base for a taxable year by (i) determining the aggregate fair market value of all repurchases, (ii) reducing that amount to the extent any statutory exceptions apply, and then (iii) reducing that amount under the netting rule. *See* proposed § 58.4501–2(c)(1). The determination of whether the de minimis exception applies would be made before applying any other statutory exceptions or adjustments under the netting rule (that is, after step (i)). *See* proposed § 58.4501–2(b)(2).

4. Reporting Requirements

The Treasury Department and the IRS also are of the view that any covered corporation that makes a repurchase must comply with the applicable reporting requirements for the stock repurchase excise tax, even if all the covered corporation's repurchases are eligible for a statutory exception or are offset by issuances. *See* proposed § 58.6011–1 as proposed elsewhere in this issue of the **Federal Register**; *see also* part XVII of this Explanation of Provisions.

B. Fractional Shares

If cash is paid to shareholders in lieu of fractional shares in connection with a reorganization under section 368(a), the payment of cash could be treated as an issuance of stock immediately followed by an offsetting repurchase of a fractional share. *See,* for example, Rev. Rul. 66–35, 1966–2 C.B. 116 (applying this ''deemed issuance and repurchase'' treatment to cash paid in lieu of a fractional share to conclude that the receipt of such cash does not violate the ''solely for voting stock'' requirement of section 368(a)(1)(B) and (C)); Rev. Rul. 69–34, 1969–1 C.B. 105 (applying such treatment to cash paid in lieu of a fractional share in an E reorganization); Rev. Rul. 74–46, 1974–1 C.B. 85 (same, for an F reorganization).

Under section 3.04(3)(b) of Notice 2023–2, a payment by a covered corporation of cash in lieu of a fractional share is not a repurchase if (i) the payment is carried out as part of a transaction that qualifies as a reorganization under section 368(a) or as a distribution to which section 355 applies, or pursuant to the settlement of an option or similar financial instrument (for example, a convertible debt instrument or convertible preferred share), (ii) the cash is not separately bargained-for consideration, (iii) the payment is carried out solely for administrative convenience, and (iv) the amount of cash paid to the shareholder in lieu of a fractional share does not exceed the value of one full share of the stock of the covered corporation.

Several stakeholders recommended that the stock repurchase excise tax should not apply to any such payments, so long as the cash paid represents solely a mechanical rounding-off of fractional shares that otherwise would be issued and is not separately bargained-for consideration.

The Treasury Department and the IRS continue to be of the view that the deemed issuance and repurchase of fractional shares pursuant to a section 368(a) reorganization, section 355 distribution, or settlement of an option or similar financial instrument should be disregarded for purposes of section 4501, so long as the general criteria described in Notice 2023–2 are satisfied. Accordingly, the proposed regulations would retain this rule with the clarification that the value of one share of stock is determined on a class-by-class basis. *See* proposed § 58.4501–2(e)(3)(ii).

C. Cash Paid to Dissenting Shareholders

If a target corporation shareholder exercises dissenters' rights with respect to a reorganization, the shareholder's shares typically are cancelled as a matter of corporate law. Upon the ultimate resolution of the shareholder's claim, those shares typically are deemed to have been acquired for cash in connection with the reorganization.

The Federal income tax treatment of payments to dissenting shareholders generally depends upon the source of the cash. If the cash is sourced from the target corporation, the acquisition generally is treated as occurring as part of a redemption separate from the reorganization. *See,* for example, Rev. Rul. 68–285 (holding that the acquisition of target corporation stock for acquiring corporation voting stock is a B reorganization notwithstanding the creation of an escrow account to pay dissenting shareholders for their stock). In contrast, if the cash is sourced from the acquiring corporation, the acquisition of the dissenting shareholders' stock may be treated as acquired by the acquiring corporation in connection with the reorganization. *See,* for example, Rev. Rul. 73–102, 1973–1 C.B. 186 (holding that the ''solely for voting stock'' requirement of section 368(a)(1)(C) is satisfied even though the acquiring corporation makes cash payments to dissenting shareholders for their target corporation stock).

A stakeholder recommended that cash paid to dissenting shareholders should not be treated as a repurchase, regardless of the source of the cash, and regardless of whether the dissenting shareholders' rights are exercised in the context of a taxable or tax-free transaction. According to the stakeholder, a shareholder's decision to exercise dissenters' rights is outside the control of the target corporation, which has no influence over how much cash ultimately may be paid to dissenters.

Notice 2023–2 does not expressly address the treatment of payments to dissenting shareholders. Thus, under Notice 2023–2, whether cash paid to

dissenting shareholders is treated as a repurchase depends on whether the transaction is treated as a section 317(b) redemption under Federal income tax principles (namely, whether the target corporation is treated as the source of the cash). The Treasury Department and the IRS continue to be of the view that the determination of whether cash paid to dissenting shareholders is treated as a repurchase should be made based upon Federal income tax principles. Accordingly, the proposed regulations would not adopt the stakeholder's recommendation.

D. Constructive Specified Affiliate Acquisition

The Treasury Department and the IRS have considered whether the acquisition by a covered corporation of a corporation or partnership that owns stock in the covered corporation should be treated as a repurchase. For example, assume that an acquiring corporation (which is a covered corporation) enters into an agreement to purchase all the stock of a privately held target corporation. Prior to the acquisition, the target corporation uses cash on hand to purchase stock of the acquiring corporation on an established securities market. After the acquisition, the target corporation becomes a specified affiliate of the acquiring corporation.

The foregoing transaction is not a section 317(b) redemption by the acquiring corporation, which does not directly acquire its stock for ''property'' within the meaning of section 317(a). The transaction also is not an acquisition of the acquiring corporation's stock by an entity that is a specified affiliate at the time of the acquisition. *See* part IV.B of this Explanation of Provisions (discussion of the determination of specified affiliate status). However, if the target corporation had purchased the acquiring corporation's stock after becoming a specified affiliate of the acquiring corporation, that purchase would have been treated as a repurchase by the acquiring corporation under section 4501(c)(2) (regarding the treatment of purchases by specified affiliates). Therefore, by purchasing the stock of the target corporation, the acquiring corporation has gained the economic benefits of repurchasing its stock without incurring a stock repurchase excise tax liability.

The Treasury Department and the IRS are of the view that the foregoing transaction should be treated as a repurchase. Accordingly, the proposed regulations would provide that a constructive specified affiliate acquisition of stock by a covered corporation is treated as a repurchase to the extent that: (i) the target corporation or partnership becomes a specified affiliate of the covered corporation; (ii) at the time the target corporation or partnership becomes a specified affiliate, it owns stock of the covered corporation that represents more than one percent of the fair market value of the target corporation or partnership as determined at such time; and (iii) the target corporation or partnership acquired such stock after December 31, 2022 (constructive specified affiliate acquisition rule). *See* proposed § 58.4501–2(f)(3)(i). Stock that is treated as repurchased in a constructive specified affiliate acquisition is treated as being repurchased at the time the corporation or partnership becomes a specified affiliate of the covered corporation. *See* proposed § 58.4501–2(g)(4).

However, the constructive specified affiliate acquisition rule would not apply to shares of covered corporation stock identified as previously having been treated as repurchased by the covered corporation under the constructive specified affiliate acquisition rule. *See* proposed § 58.4501–2(f)(3)(ii).

If the corporation or partnership is unable to specifically identify which shares of stock of the covered corporation the corporation or partnership is treated as holding at the time it becomes a specified affiliate, the covered corporation must treat the corporation or partnership as holding the most recently acquired shares of the stock of the covered corporation. *See* proposed § 58.4501–2(f)(3)(iii).

The constructive specified affiliate acquisition rule would apply regardless of whether the acquisition is a taxable transaction or a tax-free acquisition. Additionally, a transaction in which a target corporation's redemption of its shares causes the target corporation to become a specified affiliate of the covered corporation would be treated as an acquisition of the target corporation by the covered corporation for purposes of the constructive specified affiliate acquisition rule.

E. Carryover of Stock Repurchase Excise Tax Base

A stakeholder requested clarification as to whether a positive or negative balance in a target corporation's stock repurchase excise tax base (that is, an excess of issuances over repurchases, or vice-versa) may carry over to the acquiring corporation following an acquisitive reorganization for purposes of determining the acquiring corporation's stock repurchase excise tax base for the taxable year that includes the acquisition. The stakeholder recommended against applying a carryover approach if the Treasury Department and the IRS exempt acquisitive reorganizations from the stock repurchase excise tax or limit its application to non-qualifying property sourced from the target corporation. *See* parts VIII.A.2 and VIII.B of this Explanation of Provisions (discussion of acquisitive reorganizations and the sourcing approach to such reorganizations). The stakeholder also contended that a non-carryover approach may be more consistent with the taxable year determination described in section 3.03(c) of Notice 2023–2.

However, the stakeholder expressed a view that if, under the proposed regulations, the stock repurchase excise tax continues to apply to non-qualifying property sourced from the acquiring corporation, then permitting the balance in a target corporation's stock repurchase excise tax base to carry over to the acquiring corporation may be reasonable, at least to the extent of any positive balance created in connection with the transaction. The stakeholder also contended that a carryover approach may be appropriate for complete liquidations to which both sections 331 and 332 apply, if the subsidiary and parent corporations are both publicly traded at the time of the liquidation.

For the reasons discussed in part XI.D of this Explanation of Provisions (discussion of carryovers and carrybacks of issuances of preferred stock), the Treasury Department and the IRS are of the view that a carryover approach is not appropriate for purposes of the stock repurchase excise tax. Accordingly, the proposed regulations would not adopt a carryover approach.

F. Exclusive List of Economically Similar Transactions

One stakeholder recommended that the Treasury Department and the IRS incorporate into the proposed regulations the approach described in Notice 2023–2, which provided an exclusive list of economically similar transactions. The stakeholder further recommended that any transactions added to this list in future guidance should be subject to the stock repurchase excise tax only on a prospective basis. Another stakeholder also recommended that guidance classifying instruments or transactions as economically similar should apply prospectively, except for any transactions deemed abusive that may warrant retroactive application.

The Treasury Department and the IRS continue to be of the view that economically similar transactions should be clearly identified in an exclusive list on which taxpayers may rely. Accordingly, the proposed regulations would retain the exclusive list described in Notice 2023–2, as modified to account for other changes in these proposed regulations. *See* proposed § 58.4501–2(e)(4).

The Treasury Department and the IRS also are of the view that additional transactions added to the list of economically similar transactions should not be required to be apply solely on a prospective basis. Although the Treasury Department and the IRS anticipate that most transactions treated as economically similar transactions would be treated as such only on a prospective basis, there may be transactions that warrant retroactive application, as noted by the other stakeholder. Accordingly, the proposed regulations would not adopt this recommendation.

G. SPACs

1. Overview

SPACs are companies that raise equity in an IPO in order to seek out and acquire an operating business in a business combination (de-SPAC transaction). A SPAC typically will issue stock to the public in the IPO and deposit the cash received in a trust. The stock is redeemable at the option of the holder, including in connection with a de-SPAC transaction. If a business combination is not completed within a specified period of time (typically, two years), the SPAC liquidates and the cash is returned to the public shareholders.

2. SPAC Redemptions and Economically Similar Transactions

Several stakeholders requested clarification regarding the application of the stock repurchase excise tax to SPAC-related section 317(b) redemptions and economically similar transactions. For example, stakeholders recommended that non-liquidating redemptions of stock by a SPAC should be wholly excepted from the stock repurchase excise tax. According to one stakeholder, a redemption of stock by a SPAC pursuant to the terms of the stock differs from a conventional stock buyback, in that the SPAC redemption effectively amounts to a return of a shareholder's capital and does not result in either stock price manipulation or accretion to other shareholders (considerations that the stakeholder hypothesized to be relevant to Congress in enacting the stock repurchase excise tax). According to another stakeholder, an exemption for non-liquidating redemptions by SPACs could be implemented by either (i) an exception to the stock repurchase excise tax for redemptions pursuant to a mandatory redemption right or a unilateral holder put option, or (ii) a broad-based exception for SPAC-related redemptions.

The Treasury Department and the IRS are of the view that adopting special rules for SPACs in the proposed regulations would not be necessary or appropriate to carry out the stock repurchase excise tax. As discussed in part II.A.1 of this Explanation of Provisions, the proposed regulations would not exempt redemptions of stock pursuant to a mandatory redemption right or a unilateral holder put option. These proposed rules would apply to SPACs as well as other taxpayers.

Several stakeholders also recommended that distributions in complete liquidation of a SPAC should not be subject to the stock repurchase excise tax, even if there is not a distribution in cancellation or redemption of all classes of stock. The stakeholders stated that this issue arises because a SPAC sponsor typically waives with respect to their shares any redemption rights in connection with a de-SPAC transaction and any rights to liquidating distributions. Consequently, when a SPAC winds up and liquidates, the shares owned by the SPAC sponsor typically will not receive a liquidating distribution.

As discussed in part VI.A.2 of this Explanation of Provisions, the proposed regulations would clarify that a distribution pursuant to a plan of complete liquidation or dissolution of a covered corporation (or an applicable foreign corporation or a covered surrogate foreign corporation) generally is not a repurchase and, thus, generally is not subject to the stock repurchase excise tax. *See* proposed § 58.4501–2(e)(5)(i).

3. Netting Rule

In certain de-SPAC transactions, the SPAC is not the acquiring corporation. Therefore, the SPAC does not issue any stock in the transaction. Stakeholders recommended that, in such transactions, the SPAC should be allowed to offset its repurchases against (i) issuances by the post-combination entity (which could be viewed as a successor to the SPAC), or (ii) issuances of exchange rights to acquire covered corporation stock issued to the owners of target partnership interests (if the de-SPAC transaction is executed through a transaction commonly referred to as an ''Up-SPAC'' transaction).

According to stakeholders, such issuances are functionally equivalent to issuances by the SPAC. Stakeholders also recommended similar expansions of the netting rule for acquisitions other than de-SPAC transactions. Alternatively, a stakeholder recommended that SPACs be permitted a one-year carryback or carryforward of excess issuances.

Notice 2023–2 addresses the foregoing issues but does not provide SPAC-specific rules. For example, if a de-SPAC transaction were to qualify as a reorganization under section 368(a), the no double benefit rule would disallow any netting rule offset for stock issued by the acquiring corporation. *See* section 3.08(4)(d) of Notice 2023–2. However, the Treasury Department and the IRS are of the view that the netting rule should not be expanded in the manner recommended by stakeholders. By its terms, the netting rule adjusts the amount of a covered corporation's stock repurchases solely by the fair market value of covered corporation stock issued or provided during the taxable year. Accordingly, the proposed regulations would not adopt these recommendations. *See also* parts XI.D (regarding a request for a one-year carryback and carryforward period for issuances of preferred stock) and XIV.F (discussion of a recommendation for a carryover approach in the context of acquisitive reorganizations and complete liquidations) of this Explanation of Provisions.

H. Treatment of Disregarded Entities

Section 301.7701–2(c)(2)(i) provides that, for Federal tax purposes, a business entity that has a single owner and that is not a corporation under § 301.7701–2(b) is disregarded as an entity separate from its owner (disregarded entity). Section 301.7701–2(c)(2)(v) provides that § 301.7701–2(c)(2)(i) does not apply for purposes of certain excise taxes set forth in § 301.7701–2(c)(2)(v)(A). Section 4501 is not included among the excise taxes set forth in § 301.7701–2(c)(2)(v)(A). Thus, the treatment of an entity as a disregarded entity under § 301.7701–2(c)(2)(i) is respected for purposes of section 4501. *See* proposed § 58.4501–5(b)(18).

I. Form 7208

In connection with the publication of Notice 2023–2, the IRS released a proposed draft of Form 7208, which it is intended that a covered corporation would use to calculate the amount of its stock repurchase excise tax. In

connection with the publication of these proposed regulations, the IRS will release an updated draft Form 7208 along with draft instructions to the Form 7208.

XV. Applicability Dates for Proposed §§ 58.4501–1 Through 58.4501–5

Proposed § 58.4501–6(a) generally would provide that proposed §§ 58.4501–1 through 58.4501–5 apply to repurchases of stock of a covered corporation occurring after December 31, 2022, and during taxable years ending after December 31, 2022, and to issuances and provisions of stock of a covered corporation occurring during taxable years ending after December 31, 2022. *See* section 7805(b)(1)(C). However, certain rules in proposed §§ 58.4501–1 through 58.4501–5 that were not described in Notice 2023–2 would apply to repurchases, issuances, or provisions of stock of a covered corporation occurring after April 12, 2024, and during taxable years ending April 12, 2024 *See* proposed § 58.4501–6(b)(1).

Except as described in the following paragraph, so long as a covered corporation consistently follows the provisions of proposed §§ 58.4501–1 through 58.4501–5, the covered corporation may rely on these proposed regulations with respect to (1) repurchases of stock of the covered corporation occurring after December 31, 2022, and on or before the date of publication of final regulations in the **Federal Register**, and (2) issuances and provisions of stock of the covered corporation occurring during taxable years ending after December 31, 2022, and on or before the date of publication of final regulations in the **Federal Register**.

In addition, so long as a covered corporation consistently follows the provisions of Notice 2023–2 corresponding to the rules in proposed §§ 58.4501–1 through 58.4501–5, the covered corporation may choose to rely on Notice 2023–2 with respect to (1) repurchases of stock of a covered corporation occurring after December 31, 2022, and on or before April 12, 2024, and (2) issuances and provisions of stock of a covered corporation occurring during taxable years ending after December 31, 2022, and on or before April 12, 2024.

A covered corporation that relies on the provisions of Notice 2023–2 corresponding to the rules in proposed §§ 58.4501–1 through 58.4501–5 with respect to (1) repurchases occurring after December 31, 2022, and on or before April 12, 2024, and (2) issuances and provisions of stock of a covered corporation occurring during taxable years ending after December 31, 2022, and on or before April 12, 2024, may also choose to rely on the provisions of proposed §§ 58.4501–1 through 58.4501–5 with respect to (1) repurchases occurring after April 12, 2024, and on or before the date of publication of final regulations in the **Federal Register**, and (2) issuances and provisions of stock of a covered corporation occurring after April 12, 2024, and on or before the date of publication of final regulations in the **Federal Register**.

XVI. Section 4501(d)

A. In General

As noted in part I.D of the Background section of this preamble, section 4501(d) provides rules for the application of the stock repurchase excise tax to acquisitions of stock of applicable foreign corporations and repurchases and acquisitions of stock of covered surrogate foreign corporations (section 4501(d) excise tax). Section 4501(f) authorizes the Secretary to prescribe regulations and other guidance as are necessary or appropriate to carry out, and to prevent the avoidance of, the purposes of section 4501, including rules for the application of section 4501(d).

Proposed § 58.4501–7 would provide rules specifically relating to the application of section 4501(d) (section 4501(d) proposed regulations). The section 4501(d) proposed regulations generally follow related rules in proposed §§ 58.4501–2 through 58.4501–4, with modifications as appropriate solely to reflect differences in the operation of section 4501(d). *See* part I.D of the Background section of this preamble. Among other differences, the section 4501(d) excise tax is imposed on an applicable specified affiliate treated as a covered corporation under section 4501(d)(1)(A) or an expatriated entity treated as a covered corporation under section 4501(d)(2)(A) (each, a section 4501(d) covered corporation). In addition, the netting rule applies only to stock issued or provided by the applicable specified affiliate or expatriated entity, as applicable, to its employees under section 4501(d)(1)(C) and (d)(2)(C), respectively.

Terms used in the section 4501(d) proposed regulations but not defined therein have the meaning provided in proposed § 58.4501–1, except that: (i) references to a ''covered corporation'' are treated as references to a ''section 4501(d) covered corporation,'' an ''applicable foreign corporation,'' or a ''covered surrogate foreign corporation,'' as the context may require; and (ii) references to a ''covered corporation'' or ''specified affiliate'' in respect of the definitions of ''employee'' and ''employer-sponsored retirement plan'' are treated solely as references to a ''section 4501(d) covered corporation.'' *See* proposed § 58.4501–7(b)(1).

Terms specifically defined in the section 4501(d) proposed regulations are solely applicable for purposes of those regulations. *See* proposed § 58.4501–7(b)(2). In particular, the section 4501(d) proposed regulations would provide definitions relevant to the section 4501(d) excise tax computation, the funding rule of proposed § 58.4501–7(e), and the application of the statutory exceptions in section 4501(e) to section 4501(d) covered corporations. *See* part XVI.D of this Explanation of Provisions (discussion of proposed funding rule).

B. Computation of Section 4501(d) Excise Tax Liability of a Section 4501(d) Covered Corporation

1. Basic Computational Rules

The section 4501(d) excise tax liability of a section 4501(d) covered corporation would be computed under rules based on the computational rules for computing the stock repurchase excise tax liability of a covered corporation, as set forth in proposed § 58.4501–2(c)(1), with certain modifications to reflect the differences relating to, among other items: (i) the application of the section 4501(d) excise tax at the level of the section 4501(d) covered corporation; (ii) the application of certain statutory exceptions in section 4501(e); and (iii) the application of the netting rule solely to stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, issued or provided by the section 4501(d) covered corporation to its employees.

The section 4501(d) proposed regulations would provide that the amount of section 4501(d) excise tax imposed on a section 4501(d) covered corporation equals the product obtained by multiplying the applicable percentage by the section 4501(d) excise tax base. *See* proposed § 58.4501–7(c)(1). The ''section 4501(d) excise tax base'' would be equal to the aggregate fair market value of all section 4501(d)(1) repurchases (as defined in proposed § 58.4501–7(b)(2)(xxii)) or section 4501(d)(2) repurchases (as defined in proposed § 58.4501–7(b)(2)(xxiii)), as applicable, during the section 4501(d) covered corporation's taxable year, reduced by (i) the fair market value of stock repurchased or

acquired during the taxable year to the extent any statutory exceptions in section 4501(e) apply, and (ii) the aggregate fair market value of stock of the applicable foreign corporation or stock of the covered surrogate foreign corporation, as applicable, to the extent the netting rule applies under section 4501(d)(1)(C) or (d)(2)(C), respectively. *See* proposed § 58.4501–7(c)(3) (section 4501(d) excise tax base), (m) (section 4501(d) statutory exceptions), and (n) (section 4501(d) netting rule).

For purposes of the section 4501(d) excise tax base, the fair market value of a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, during the section 4501(d) covered corporation's taxable year generally would be determined in the same manner as in proposed § 58.4501–2(h). However, the section 4501(d) covered corporation, rather than the covered corporation, would be required to determine the value of the stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, by applying one of the acceptable methods of valuation set forth in proposed § 58.4501–7(l)(2)(ii), for stock traded on an established securities market, or under the principles of § 1.409A–1(b)(5)(iv)(B)(*1*), for stock not so traded.

In either case, the section 4501(d) covered corporation must be consistent in its application of the valuation methodology. For example, the market price of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is traded on an established securities market must be determined by consistently applying one, but not more than one, of the acceptable methods to all section 4501(d)(1) repurchases with respect to an applicable foreign corporation or all section 4501(d)(2) repurchases with respect to a covered surrogate foreign corporation, in the same taxable year of the applicable foreign corporation or covered surrogate foreign corporation, as applicable. *See* proposed § 58.4501–7(l)(2)(iv). If an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, does not have a taxable year for Federal income tax purposes, the calendar year would be treated as the taxable year for this purpose.

2. Section 4501(d) De Minimis Exception

The section 4501(d) proposed regulations would provide that a section 4501(d) covered corporation is not subject to the section 4501(d) excise tax with regard to a taxable year of the section 4501(d) covered corporation if, during that taxable year, the aggregate fair market value of all section 4501(d)(1) repurchases with respect to all applicable specified affiliates or all section 4501(d)(2) repurchases with respect to an expatriated entity, as applicable, does not exceed $1,000,000 (section 4501(d) de minimis exception). *See* proposed § 58.4501–7(c)(2)(i). The determination of whether the section 4501(d) de minimis exception applies is made before applying any section 4501(d) statutory exception or the section 4501(d) netting rule, which are discussed in parts XVI.I and J of this Explanation of Provisions, respectively.

In applying the section 4501(d) de minimis exception to applicable specified affiliates of an applicable foreign corporation in cases in which the applicable specified affiliates have different taxable years, each applicable specified affiliate (tested affiliate) would be required to aggregate section 4501(d)(1) repurchases that occur during its taxable year (tested taxable year), including section 4501(d)(1) repurchases by other applicable specified affiliates of the same applicable foreign corporation that occur during the tested affiliate's taxable year, regardless of the taxable year ends of the other applicable specified affiliates. In other words, the section 4501(d) de minimis exception would be applied to the overlapping portion of the taxable years of all applicable specified affiliates of an applicable foreign corporation.

The Treasury Department and the IRS are of the view that applying the section 4501(d) de minimis exception to the overlapping portion of the taxable years of all applicable specified affiliates is consistent with the statute, which applies the de minimis exception to the total value of the stock repurchased during the taxable year without regard to the identity of the person effecting the repurchase, and also precludes the use or formation of multiple applicable specified affiliates for the purpose of improperly manipulating the application of the de minimis exception.

For example, assume that an applicable foreign corporation, FX, has a taxable year end of June 30 and owns the stock of two domestic corporations, US1 and US2, that are applicable specified affiliates. US1 has a taxable year end of June 30, and US2 has a taxable year end of December 31. In applying the section 4501(d) de minimis exception to US1 in its taxable year ending June 30, 2026, the aggregate fair market value of all section 4501(d)(1) repurchases with respect to all applicable specified affiliates during its taxable year ending June 30, 2026, is taken into account. Consequently, any acquisition of stock of FX that occurs from July 1, 2025, through June 30, 2026, whether by US1 or US2, would be included in applying the section 4501(d) de minimis exception to US1's taxable year ending June 30, 2026.

C. Certain Rules for Section 4501(d)(2) Repurchases

1. Coordination Rules for Section 4501(d)(2) Repurchases

The section 4501(d) proposed regulations would provide certain coordination rules relating to section 4501(d)(2) repurchases. In particular, the section 4501(d) proposed regulations would provide a priority rule for a transaction that is otherwise both a section 4501(d)(1) repurchase and a section 4501(d)(2) repurchase, and a coordination rule for multiple expatriated entities with respect to a covered surrogate foreign corporation.

With respect to the priority rule, one stakeholder recommended that, if both section 4501(d)(1) and (2) could apply to a transaction, only section 4501(d)(1) should be applied. The Treasury Department and the IRS recognize that, in certain limited situations, acquisitions of stock of a covered surrogate foreign corporation could be subject to the section 4501(d) excise tax under both section 4501(d)(1) and (2). The Treasury Department and the IRS agree that a coordination rule is appropriate but are of the view that section 4501(d)(2) should take priority over section 4501(d)(1). Section 4501(d)(2) is specifically targeted to the repurchase of stock of a covered surrogate foreign corporation by the covered surrogate foreign corporation or the acquisition of the stock of a covered surrogate foreign corporation by a specified affiliate of such corporation. Accordingly, it is appropriate to give primacy to section 4501(d)(2) in that context.

Further, the proposed approach accords with the statutory regime that bifurcates between the operation of section 4501(d)(1) and (2) because this approach would apply section 4501(d)(2) consistently to such repurchases or acquisitions instead of applying a mix of section 4501(d)(1) or (d)(2) depending on the circumstances of a particular acquisition. This mixed application of section 4501(d)(1) and (d)(2) could also present difficulties from a computational perspective. Accordingly, to the extent any repurchase or acquisition of stock of a covered surrogate foreign corporation would be both a section 4501(d)(1) repurchase and a section 4501(d)(2)

repurchase, the repurchase or acquisition would be only a section 4501(d)(2) repurchase. *See* proposed § 58.4501–7(d)(1).

With respect to the coordination rule, section 6.02(5) of Notice 2023–2 requested comments on how the section 4501(d) excise tax liability should be allocated in circumstances in which there are multiple expatriated entities, each of which is treated as a covered corporation with respect to a covered surrogate foreign corporation. A stakeholder recommended that the parties be permitted to contractually allocate liability for the section 4501(d) excise tax in this circumstance. The stakeholder stated that permitting the parties to determine their own allocation of section 4501(d) excise tax liability, rather than mandating an allocation scheme, would allow taxpayers to consider a number of ancillary factors relevant to the allocation, such as the cash flow needs of particular entities. The stakeholder suggested that the government's interest in the payment and collection of the section 4501(d) excise tax could be protected through imposing joint and several liability for the tax liability with respect to each relevant expatriated entity, notwithstanding the privately contracted liability allocation, and through coordination of the reporting of the stock repurchase excise tax on Form 720.

The Treasury Department and the IRS are of the view that, under the plain language of section 4501(d)(2), if there are multiple expatriated entities with respect to a covered surrogate foreign corporation, each expatriated entity is separately liable for the section 4501(d) excise tax with respect to all section 4501(d)(2) repurchases with respect to the covered surrogate foreign corporation's stock. In particular, under the language of the statute, each expatriated entity is liable for the section 4501(d) excise tax on the full amount of stock repurchases by a covered surrogate foreign corporation and its specified affiliates, and the statute does not provide any method of allocation among multiple expatriated entities. For example, if there are two expatriated entities with respect to the same covered surrogate foreign corporation, and the covered surrogate foreign corporation repurchases $100x of stock during the year, then under the statute's plain language, both expatriated entities would be liable for any section 4501(d) excise tax with respect to the $100x repurchase.

Accordingly, the section 4501(d) proposed regulations would follow the statute by providing the default rule that multiple expatriated entities are each liable for the full amount of section 4501(d) excise tax with respect to the covered surrogate foreign corporation. However, the section 4501(d) proposed regulations would provide procedures to allow one of those multiple expatriated entities to report and pay its full excise tax obligation and thereby relieve the remaining expatriated entities of their obligations to report and pay the same amount of section 4501(d) excise tax with respect to the section 4501(d)(2) repurchases during the paying expatriated entity's taxable year. *See* proposed § 58.4501–7(d)(2)(ii); *see also* proposed § 58.4501–7(q)(3) (*Example 3*) for an illustration of this rule.

The Treasury Department and the IRS are of the view that allowing multiple expatriated entities to pay different portions of the section 4501(d) excise tax liability would be too complex and that the most straightforward and administrable approach would be to require one expatriated entity to pay its full section 4501(d) excise tax liability for the taxable year and thereby relieve each other expatriated entity's liability for the section 4501(d) excise tax. Further, as relevant to the stakeholders' recommendations, multiple expatriated entities still could choose the expatriated entity that fully reports and pays its section 4501(d) excise tax liability, and they could provide for payments or reimbursements among themselves by private contract.

2. Example for Entity Subject to Section 7874(b)

One stakeholder requested that the proposed regulations clarify that an entity described in section 7874(b) is treated as a domestic corporation for purposes of applying section 4501, and so is subject to section 4501(a) as a covered corporation (and is not a covered surrogate foreign corporation under section 4501(d)(2)). The Treasury Department and the IRS agree with this request because this result follows from the plain language of sections 4501(d) and 7874. *See* proposed § 58.4501–5(b)(40) (*Example 40*) for an illustration of this result.

3. Transfers Among the Covered Surrogate Foreign Corporation and Its Specified Affiliates

One stakeholder requested clarification of whether section 4501(d)(2) applies to transfers of stock of a covered surrogate foreign corporation among related entities (in particular, among a covered surrogate foreign corporation and its specified affiliates). Those transactions are section 4501(d)(2) repurchases because, unlike section 4501(d)(1), section 4501(d)(2) is not limited to repurchases or acquisitions of stock from persons who are not the covered surrogate foreign corporation or a specified affiliate of the covered surrogate foreign corporation. *See* proposed § 58.4501–7(q)(2) (*Example 2*) for an illustration of this result.

D. The Proposed Funding Rule

1. The Notice Funding Rule

Section 3.05(2)(a)(ii) of Notice 2023–2 provides that an applicable specified affiliate is treated as acquiring stock of an applicable foreign corporation if (i) the applicable specified affiliate funds by any means (including through distributions, debt, or capital contributions) the repurchase or acquisition of stock of the applicable foreign corporation by the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and (ii) such funding is undertaken with a principal purpose of avoiding the stock repurchase excise tax (Notice funding rule). The Notice funding rule also provides that such a principal purpose is deemed to exist if the funding (other than through distributions) occurs within two years of the funded entity's repurchase or acquisition of stock of the applicable foreign corporation (per se rule).

Numerous stakeholders provided feedback on the Notice funding rule. Stakeholders generally asserted that the Notice funding rule and, in particular, the per se rule were overbroad for various reasons. This feedback was considered in drafting and revising the version of the funding rule in the section 4501(d) proposed regulations (proposed funding rule) and is discussed in part XVI.D.2 of this Explanation of Provisions.

2. The Proposed Funding Rule

a. General Structure and the Rebuttable Presumption

The proposed funding rule would retain the general structure of the Notice funding rule, but with substantial modifications that include replacing the per se rule with a rebuttable presumption that applies in limited circumstances. Under the proposed funding rule, an applicable specified affiliate of an applicable foreign corporation would be treated as acquiring stock of the applicable foreign corporation to the extent the applicable specified affiliate (i) funds by any means (including through distributions, debt, or capital contributions), directly or indirectly, an AFC repurchase or an

acquisition of stock of an applicable foreign corporation by a specified affiliate of an applicable foreign corporation that is not an applicable specified affiliate of the applicable foreign corporation (such entity, a relevant entity, and such repurchase or acquisition, a covered purchase) (ii) with a principal purpose of avoiding the section 4501(d) excise tax (a funding with such a principal purpose, a covered funding). If a principal purpose of a funding is to fund, directly or indirectly, a covered purchase, then with respect to that funding, there is a principal purpose of avoiding the section 4501(d) excise tax. *See* proposed § 58.4501–7(e)(1); *see also* proposed § 58.4501–7(j) (definition of ''AFC repurchase''). Proposed § 58.4501–7(p)(3) (*Example 3*), (p)(4) (*Example 4*), and (p)(7) (*Example 7*) would illustrate the application of the proposed funding rule.

The section 4501(d) proposed regulations would not include the per se rule. Instead, a principal purpose described in proposed § 58.4501–7(e)(1) would be presumed to exist if the applicable specified affiliate funds by any means, directly or indirectly, a downstream relevant entity, and the funding occurs within two years of a covered purchase by or on behalf of the downstream relevant entity (rebuttable presumption). A covered purchase ''on behalf of'' a downstream relevant entity would include an acquisition by an agent or nominee of the downstream relevant entity for the downstream relevant entity's account. The term ''downstream relevant entity'' would be defined as a relevant entity (i) 25 percent or more of the stock of which is owned (by vote or by value), directly or indirectly, by, individually or in aggregate, one or more applicable specified affiliates of an applicable foreign corporation, or (ii) 25 percent or more of the capital or profits interests in which are held, directly or indirectly, by, individually or in aggregate, one or more applicable specified affiliates of an applicable foreign corporation. The rebuttable presumption may be rebutted only if facts and circumstances clearly establish that there was not a principal purpose described in proposed § 58.4501–7(e)(1).

Thus, the rebuttable presumption would apply only to ''downstream'' fundings (that is, fundings of, and covered purchases by or on behalf of, relevant entities in which one or more applicable specified affiliates have a material direct or indirect ownership interest). The rebuttable presumption would not otherwise apply. Proposed § 58.4501–7(p)(5) (*Example 5*) and (p)(6) (*Example 6*) would illustrate the application of the rebuttable presumption.

b. Timing and Allocation Rules

The proposed funding rule would provide rules for determining the date that an applicable specified affiliate is treated, by reason of a covered funding, as acquiring stock of an applicable foreign corporation. More specifically, the proposed funding rule would provide that stock of an applicable foreign corporation that is treated as acquired by an applicable specified affiliate by reason of a covered funding is treated as acquired on the later of the date of the covered funding or the covered purchase to which the covered funding is allocated.

The proposed funding rule also would provide specific rules allocating covered fundings to covered purchases to determine the amount of a deemed acquisition pursuant to the proposed funding rule. The proposed funding rule would provide that the amount of stock of an applicable foreign corporation acquired in a covered purchase that is treated as acquired by an applicable specified affiliate is equal to the amount of the applicable specified affiliate's covered fundings that are allocated to a covered purchase. To the extent covered fundings are allocated to a covered purchase, those fundings would not be allocated to any other covered purchases.

The proposed funding rule would provide that a covered purchase is treated as made first from covered fundings such that, to the extent there is both a covered funding and a covered purchase subject to the proposed funding rule, such covered purchase is treated as funded by the covered funding before fundings received from other sources.

The proposed funding rule would further provide that, if there is a single covered funding, the covered funding is allocated to a covered purchase to the extent of the lesser of the amount of the covered funding or the amount of the covered purchase. If there are multiple covered fundings, and if the aggregate amount of those fundings exceeds the amount of the covered purchase, then covered fundings would be allocated to the covered purchase in the order in which the covered fundings occur (a ''first in, first out'' approach). If multiple covered fundings occur simultaneously, those covered fundings would be allocated to the covered purchase on a pro rata basis.

If there are multiple covered purchases, then covered fundings would be allocated to the covered purchases in the order in which the covered purchases occur. If multiple covered purchases occur simultaneously, then covered fundings would be allocated to those simultaneous covered purchases on a pro rata basis.

3. Response to Feedback on the Notice Funding Rule

a. Authority for the Notice Funding Rule

Stakeholders requested that the Notice funding rule be withdrawn for various reasons, including that, in the stakeholders' view, the Notice funding rule is not supported by the statutory language and is contrary to congressional intent.

Stakeholders asserted that the Notice funding rule is contrary to the statutory language in section 4501(d)(1) because that language requires the applicable specified affiliate to acquire the stock of the applicable foreign corporation, as opposed to merely funding a separate entity's acquisition of such stock. Several stakeholders also alleged that section 4501(f) does not provide sufficient authority for the Notice funding rule because the Notice funding rule does not appropriately target the avoidance of section 4501(d)(1) and does not carry out, or prevent the avoidance of, the purposes of section 4501.

Stakeholders also asserted that the Notice funding rule and the per se rule are otherwise overbroad, particularly given that section 4501(d)(1) only applies to a set of transactions—certain acquisitions by applicable specified affiliates of stock of an applicable foreign corporation—that stakeholders alleged occur rarely, if ever (for example, because foreign law prohibits a subsidiary from owning stock of its ultimate parent entity).

As a threshold matter, the Treasury Department and the IRS continue to be of the view that, for several reasons, a version of the funding rule is necessary to carry out the purposes of, and to prevent avoidance of, the section 4501(d) excise tax. As acknowledged by stakeholders, an applicable specified affiliate potentially could avoid the section 4501(d) excise tax with relative ease absent a funding rule. Accordingly, the Treasury Department and the IRS are of the view that a version of the funding rule is necessary to prevent such avoidance of the section 4501(d) excise tax.

The Treasury Department and the IRS are also of the view that the proposed funding rule is an appropriate and permissible exercise of the broad grant of authority in section 4501(f) to prescribe regulations and other

guidance as necessary or appropriate to carry out, and to prevent the avoidance of, the purposes of the stock repurchase excise tax, including guidance for the application of the rules of section 4501(d). As one stakeholder noted, statutory grants of regulatory authority like section 4501(f) generally are understood to be broad. For example, *see* H.R. Rep. No. 100–795, at 54 (1988) (stating that the Treasury Department has, under section 382(m) of the Code, ''broad regulatory authority to prescribe any regulations necessary or appropriate to carry out the purposes of the loss limitation provisions''). Further, longstanding rules in other Treasury regulations provide that, if a taxpayer funds an acquisition of property by a relevant related party rather than acquiring the property itself, the taxpayer can be treated in appropriate circumstances as acquiring the property for certain Federal income tax purposes if the funding satisfies a principal purpose requirement. *See* §§ 1.304–4(b)(1); 1.956–1(b)(1)(iii). The Treasury Department and the IRS therefore are of the view that the statutory language of section 4501, including section 4501(f), authorizes the proposed funding rule.

The Treasury Department and the IRS also are of the view that the alleged rarity of relevant acquisitions by applicable specified affiliates does not address the concern that an applicable specified affiliate potentially could, with relative ease, fund another entity's repurchase or acquisition of the stock of an applicable foreign corporation. One stakeholder noted survey results indicating that some respondents do have acquisitions of parent stock by subsidiaries in their multinational groups. The enactment of section 4501(d)(1) indicates congressional intent to address acquisitions of stock of an applicable foreign corporation by applicable specified affiliates. In addition, other provisions in the Code and Treasury regulations recognize and address the Federal income tax consequences of a subsidiary's acquisition of a parent entity's stock. For example, Treasury regulations specifically address certain transactions undertaken by taxpayers involving a subsidiary's acquisition of parent stock. *See* § 1.367(b)–10 (providing treatment of certain transactions in which a foreign subsidiary acquires stock of a parent corporation).

In addition, as discussed in part XVI.D.2.a of this Explanation of Provisions, the proposed funding rule would not include the per se rule. Instead, the proposed funding rule would provide a more targeted rebuttable presumption that applies only with respect to downstream relevant entities. The rebuttable presumption would apply over the same timeframe as the per se rule; however, unlike the per se rule, the rebuttable presumption would apply only to a limited category of fundings and could be rebutted. This replacement of the per se rule with the rebuttable presumption would materially narrow the scope of the proposed funding rule relative to the Notice funding rule. The Treasury Department and the IRS are of the view that this narrower scope of the proposed funding rule further addresses concerns raised by stakeholders related to the Notice funding rule and the per se rule.

b. Principal Purpose Standard

Certain stakeholders questioned how to determine whether a taxpayer has a principal purpose of avoiding the stock repurchase excise tax under the Notice funding rule. The proposed funding rule would clarify that, if a principal purpose of the covered funding is to fund, directly or indirectly, a covered purchase, then there is a principal purpose of avoiding the section 4501(d) excise tax.

In addition, one stakeholder recommended that the Notice funding rule provide specific factors to be considered in determining whether a taxpayer has a principal purpose of avoiding the stock repurchase excise tax. The proposed funding rule would not add such specific factors because the relevant factors may vary depending on the particular facts and circumstances in each case. The Treasury Department and the IRS are of the view that this approach is in accordance with other statutory and regulatory rules involving or requiring a principal purpose, as those rules typically do not provide specific factors for determining whether a principal purpose is present. However, the proposed funding rule would clarify that whether a covered funding is described in proposed § 58.4501–7(e)(1) is determined based on all the facts and circumstances.

Further, another stakeholder recommended that the principal purpose standard be changed from requiring ''a'' principal purpose of avoidance to requiring ''the'' principal purpose of avoidance (akin to the standard in section 269 of the Code). The proposed funding rule would not change its principal purpose standard in this manner. The Treasury Department and the IRS are of the view that requiring ''a'' principal purpose is common in existing rules analogous to the proposed funding rule. The Treasury Department and the IRS are of the view that, if the other requirements to apply the proposed funding rule are met, then it would be appropriate for the proposed funding rule to apply if ''a'' principal purpose of the funding is described in proposed § 58.4501–7(e)(1).

c. Limitation to Certain Relevant Entities

Several stakeholders recommended that the per se rule be limited to acquisitions by certain persons other than the applicable foreign corporation, such as subsidiaries of an applicable specified affiliate. Another stakeholder similarly recommended limiting the application of the Notice funding rule to subsidiaries of the applicable specified affiliate by interpreting the term ''acquisition'' to include indirect acquisitions by applicable specified affiliates through domestic subsidiaries, domestic and foreign partnerships, and controlled foreign corporations (CFCs) owned (within the meaning of section 958(a) of the Code) by applicable specified affiliates. (Note that such intermediate domestic entities also would be applicable specified affiliates, so their acquisitions would separately be subject to section 4501(d)(1)).

The Treasury Department and the IRS are of the view that the application of the proposed funding rule should not be limited in this manner. This type of limitation on the scope of the funding rule potentially would allow the rule to be avoided with relative ease through funding to whichever related entities are excluded from the scope of the proposed funding rule. Accordingly, the proposed funding rule could apply regardless of whether the funded entity is an applicable foreign corporation, brother-sister entity, or subsidiary of the applicable specified affiliate.

However, the Treasury Department and the IRS are of the view that applying the rebuttable presumption solely to fundings of downstream relevant entities is appropriate. In line with observations from certain stakeholders, these ''downstream'' fundings—in which one or more applicable specified affiliates have a material ownership stake in the relevant entity that receives a funding and by or on behalf of whom the covered purchase is made—strongly implicate the anti-avoidance concerns that motivate the proposed funding rule. Accordingly, the Treasury Department and the IRS are of the view that the rebuttable presumption would appropriately be applied in that context.

d. Recommended Exclusions From the Notice Funding Rule

Stakeholders suggested that, if the Notice funding rule is retained, then certain ordinary-course fundings should be excluded from the meaning of a ''funding,'' such as arm's-length payments (including payments for inventory, services, or treasury functions) or payments of royalties or interest. In addition, one stakeholder requested that a ''funding'' should not include payments made pursuant to a so-called ''recharge agreement'' in which an applicable specified affiliate reimburses the applicable foreign corporation for providing stock to the applicable specified affiliate's employees.

Several stakeholders also requested that certain types of taxpayers, such as foreign banks or financial institutions, should be exempt from the Notice funding rule because they frequently engage in intercompany financing transactions as part of their ordinary course of business (and such intercompany activity should not be viewed as abusive or as avoidance of the section 4501(d) excise tax).

The section 4501(d) proposed regulations would not adopt exclusions from the rebuttable presumption or the proposed funding rule for specific types of fundings or for taxpayers in specific industries. The targeted scope of the rebuttable presumption means that only a limited category of fundings would be subject to the rebuttable presumption. The Treasury Department and the IRS are of the view that the elimination of the per se rule and the targeted nature of the rebuttable presumption appropriately address the concerns reflected in the feedback requesting these exclusions. Further, the Treasury Department and the IRS are of the view that exclusions for taxpayers in specific industries are not appropriate in this context as a general matter. The Treasury Department and the IRS also are of the view that the manner in which the exception for repurchases or acquisitions by a dealer in securities would apply with respect to covered purchases further addresses these concerns. *See* proposed § 58.4501–7(m)(4).

e. Treaty and Extraterritoriality Concerns

Stakeholders also asserted that the Notice funding rule, including the per se rule, overrides arm's-length transfer pricing principles, is contrary to bilateral income tax treaties and Organisation for Economic Co-operation and Development (OECD) efforts involving extraterritorial taxation, and creates the risk of other countries imposing an analogous rule with respect to fundings provided to a U.S. corporation to repurchase its own stock.

The Treasury Department and the IRS are of the view that the Notice funding rule generally does not implicate these concerns. The section 4501(d) excise tax is imposed on an applicable specified affiliate or expatriated entity, and not the applicable foreign corporation or covered surrogate foreign corporation, as applicable. The section 4501(d) excise tax is also an excise tax and not an income tax. In any event, the Treasury Department and the IRS also are of the view that the tailoring of the proposed funding rule—including the elimination of the per se rule and the other limits described previously—would appropriately address the concerns motivating this feedback.

f. Funding From Multiple Sources

Stakeholders also requested guidance on how to apply the funding rule if a funded entity receives funding from multiple sources. In those cases, different ordering rules or conventions could result in differences in the potential section 4501(d) excise tax liability after application of the funding rule.

The Treasury Department and the IRS agree that guidance on ordering rules or conventions would be helpful in applying the proposed funding rule. Accordingly, the proposed fund rule would include the allocation and timing rules previously described in part XVI.D.2.b of this Explanation of Provisions.

The Treasury Department and the IRS considered other timing and allocation rules in developing the proposed funding rule, such as allocation rules that allocate a specific funding amount to a covered purchase if the particular funds or assets can be ''traced'' to a covered purchase, or allocation rules that base the allocation on a proration of fundings received from all sources. The Treasury Department and the IRS are of the view that proposed ordering rules should: (i) recognize the typically fungible nature of liquid assets; (ii) take into account that transactions subject to the proposed funding rule have a principal purpose of funding a stock repurchase or acquisition; and (iii) be administrable.

The Treasury Department and the IRS are of the view that the allocation method in the proposed funding rule is both reasonable and administrable. As previously described, the proposed funding rule would provide that a covered purchase is treated as made first from covered fundings such that, to the extent there is both a covered funding and a covered purchase subject to the proposed funding rule, such covered purchase is treated as funded by the covered funding before fundings received from other sources. The Treasury Department and the IRS are of the view that treating a funding made with a relevant principal purpose as actually being used for that purpose is appropriate.

Further, the proposed allocation rules would be more administrable than other allocation rules (such as a pure ''tracing'' approach, or a proration of fundings from all sources) because the proposed rules would not require taxpayers to track or order fundings other than covered fundings. Additionally, a pure ''tracing'' rule potentially would permit avoidance of the funding rule with relative ease given the fungible nature of liquid assets that often may be most relevant to the proposed funding rule.

E. Status as an Applicable Foreign Corporation, Covered Surrogate Foreign Corporation, Applicable Specified Affiliate, Relevant Entity, Specified Affiliate

1. Status as an Applicable Foreign Corporation or a Covered Surrogate Foreign Corporation

The rules for determining when a corporation becomes or ceases to be an applicable foreign corporation or a covered surrogate foreign corporation are provided in proposed § 58.4501–7(f). These rules are based on the rules in proposed § 58.4501–2(d) (duration of covered corporation status) for determining when a corporation becomes or ceases to be a covered corporation. Under proposed § 58.4501–7(f)(2), in general, a corporation becomes an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, at the beginning of the initiation date (as defined in proposed § 58.4501–1(b)(15)), and a corporation ceases to be an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, at the end of the cessation date (as defined in proposed § 58.4501–1(b)(2)). Proposed § 58.4501–7(f)(2) and (3), respectively, would provide additional rules for when (i) a corporation transfers its assets in an inbound or outbound F reorganization, or (ii) a foreign corporation ceases to be an applicable foreign corporation or a covered surrogate foreign corporation as part of a transaction that includes a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable.

2. Status as an Applicable Specified Affiliate, Relevant Entity, or Specified Affiliate

The rules for determining whether a corporation or a partnership is an applicable specified affiliate or a relevant entity of an applicable foreign corporation or a specified affiliate of a covered surrogate foreign corporation, as applicable, are provided in proposed § 58.4501–7(g). These rules are based on the rules in proposed § 58.4501–2(f)(2) (determination of specified affiliate status). Under proposed § 58.4501–7(g)(1), the determination of whether a corporation or partnership is an applicable specified affiliate or a relevant entity of an applicable foreign corporation or a specified affiliate of a covered surrogate foreign corporation, as applicable, is made whenever such determination is relevant. In the case of tiered ownership structures, the rules for determining indirect ownership are consistent with the rules provided in § 58.4501–2(f)(2)(ii), except for a special rule (described in part XVI.F of this Explanation of Provisions) that applies for purposes of determining whether a domestic entity is a direct or indirect partner in a partnership. *See* proposed § 58.4501–7(g)(2).

Finally, similar to proposed § 58.4501–2(f)(3), proposed § 58.4501–7(g)(3) describes the tax consequences if a corporation or partnership becomes a specified affiliate and owns stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, that was acquired after December 31, 2022. In this case, for purposes of applying the section 4501(d) proposed regulations, the corporation or partnership is generally treated as acquiring such stock immediately after the corporation or partnership becomes a specified affiliate.

F. Foreign Partnerships That are Applicable Specified Affiliates

1. In General

Section 4501(d)(1) provides that, if a foreign partnership that is a specified affiliate of an applicable foreign corporation has a direct or indirect partner that is a domestic entity, then the foreign partnership is an applicable specified affiliate of the application foreign corporation. The rules for determining if a foreign partnership is an applicable specified affiliate are in proposed § 58.4501–7(h).

2. Direct and Indirect Partners

In section 6 of Notice 2023–2, the Treasury Department and the IRS requested comments regarding the factors that should be considered in determining whether a domestic entity is an indirect partner of a foreign partnership for purposes of section 4501(d)(1).

One stakeholder recommended that indirect domestic partners not be taken into account if they hold their interests in the foreign partnership through an intermediate foreign corporation or an intermediate domestic corporation or partnership. (In the latter case, the intermediate domestic corporation or partnership itself already would be a direct or indirect domestic partner.) The stakeholder argued that this recommendation is consistent with general Federal income tax principles and would simplify the determination of whether a domestic entity is an indirect partner of a foreign partnership. Another stakeholder recommended that the stock repurchase excise tax apply to acquisitions by a foreign partnership in which a domestic entity owns (within the meaning of section 958(a)) its interest directly or indirectly through a CFC.

The Treasury Department and the IRS do not agree with the first recommendation because the statute does not limit indirect ownership to indirect ownership solely through a foreign partnership. Moreover, limiting the scope of indirect ownership in this manner for purposes of determining whether a foreign partnership is an applicable specified affiliate could facilitate avoidance of the statute. For instance, a domestic entity could form a wholly owned foreign corporation to hold the domestic entity's interest in a foreign partnership in which the domestic entity otherwise would be a domestic entity partner for purposes of section 4501(d)(1). The Treasury Department and the IRS are of the view that this type of transaction should not alter whether a foreign partnership is an applicable specified affiliate for purposes of section 4501(d)(1). Accordingly, section 4501(d) proposed regulations would not follow this approach.

With respect to the second recommendation, although the stakeholder made this suggestion in the context of interpreting the term ''acquisition,'' the Treasury Department and the IRS agree that a domestic entity that owns its interest in a foreign partnership through a CFC generally should be an indirect partner for purposes of determining whether a foreign partnership is an applicable specified affiliate.

The section 4501(d) proposed regulations would, in part, follow a similar approach. Specifically, the section 4501(d) proposed regulations would provide that a domestic entity is an indirect partner with respect to a foreign partnership if the domestic entity owns an interest in the foreign partnership through: (i) one or more foreign partnerships; (ii) one or more foreign corporations controlled by one or more domestic entities (domestic control requirement), or (iii) an ownership chain with one or more entities described in the preceding clauses (i) and (ii). *See* proposed § 58.4501–7(h)(2)(ii).

For this purpose, a foreign corporation is controlled by one or more domestic entities if more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote or the total value of the stock of such corporation is owned, directly or indirectly, in aggregate by one or more domestic entities. *See* proposed § 58.4501–7(h)(3). These domestic entities do not need to be related to each other.

However, the section 4501(d) proposed regulations would provide that a domestic entity is not treated as indirectly owning stock in a foreign corporation or an interest in a foreign partnership solely by reason of owning, directly or indirectly, stock of the applicable foreign corporation. *See* proposed § 58.4501–7(h)(4). For example, assume that a U.S. corporation (USX) directly owns stock of an applicable foreign corporation (FP), which directly owns 100 percent of the stock of two foreign corporations, FS1 and FS2. FS1 and FS2, in aggregate, own all the interests in a foreign partnership (FPS). Under these facts, USX would not be treated as indirectly owning stock of FS1 or FS2 or an interest in FPS.

The Treasury Department and the IRS are of the view that, absent the domestic control requirement, look-through for indirect ownership for this purpose under the statute would require full, proportionate look-through of all foreign corporations. *See* part XVI.E.2 of this Explanation of Provisions. The Treasury Department and the IRS are of the view that it is appropriate to narrow the application of this statutory rule in this context to address compliance and administrability concerns.

3. The Proposed De Minimis Rule for Domestic Entity Ownership

Several stakeholders recommended that the Treasury Department and the IRS: (i) adopt a de minimis threshold for direct or indirect domestic ownership of a foreign partnership before the foreign partnership is treated as an applicable specified affiliate; and (ii) limit the

applicability of section 4501(d)(1) to foreign partnerships to situations in which the domestic entity partner is related to the relevant applicable foreign corporation. Although the plain language of the statute does not provide for either of these limitations, the stakeholders contended that a de minimis exception or a relatedness requirement (or both) are appropriate in light of the statute's focus on entities with a meaningful U.S. connection and the potential diligence issues with determining indirect domestic ownership for foreign partnerships potentially subject to the section 4501(d) excise tax.

One stakeholder recommended a de minimis threshold of one or two percent, analogizing to de minimis exceptions under other Code provisions (*see* §§ 1.351–1(c)(7), *Example 1* (treating a less-than-one percent interest as de minimis for purposes of section 351(e)), and 1.1202–2(a)(2) (applying a two percent de minimis threshold for purposes of section 1202 of the Code)). Another stakeholder recommended a 10 percent de minimis threshold, analogizing to § 1.59A–7(d)(2) (exception for base erosion tax benefits for certain small partners). A stakeholder also suggested that the section 4501(d) proposed regulations should require the domestic entity partner to be related (within the meaning of section 267 of the Code) to the applicable foreign corporation in order to be consistent with the purpose of the stock repurchase excise tax, which (in the stakeholder's view) was to impose a tax on repurchases or acquisitions of stock of publicly traded corporations and persons related to them.

The Treasury Department and the IRS are of the view that a de minimis threshold would be appropriate to address compliance and administrability concerns regarding the determination of when direct or indirect ownership by domestic entity partners causes a foreign partnership to be an applicable specified affiliate. Accordingly, the section 4501(d) proposed regulations would provide that a foreign partnership with one or more direct or indirect domestic entity partners is not considered an applicable specified affiliate if the domestic entities hold, directly or indirectly, in aggregate, less than five percent of the capital and profits interests in the foreign partnership. *See* proposed § 58.4501–7(h)(5).

The Treasury Department and the IRS also are of the view that, because the statute does not require any relationship between the direct or indirect domestic entity partner and the applicable foreign corporation of which the foreign partnership is a specified affiliate, no such relationship is required. The addition of such a relatedness requirement in the section 4501(d) proposed regulations would be a departure from the statutory structure. However, the de minimis rule would provide a minimum threshold of direct or indirect domestic ownership required for treating a foreign partnership as an applicable specified affiliate.

4. Domestic Entity

A stakeholder recommended that a domestic entity that is a disregarded entity and holds an interest in a partnership should not itself be treated as a partner. The statute does not treat a ''true'' U.S. branch as a domestic entity; therefore, the Treasury Department and the IRS agree with this recommendation. *See* proposed § 58.4501–7(b)(2)(x) (definition of ''domestic entity'').

5. Filing Requirements

Section 6.02(6) of Notice 2023–2 requested comments on whether the foreign partnership or the domestic entity partner should be required to file the Form 720 and pay the stock repurchase excise tax. Several stakeholders recommended that the domestic entity partner be required to file the stock repurchase excise tax return and pay the stock repurchase excise tax. One stakeholder requested guidance regarding the level of diligence required to determine whether a foreign partnership has a direct or indirect domestic entity as a partner. The stakeholder recommended that the diligence process should not impose undue burdens and expense on taxpayers given the limited application of the stock repurchase excise tax to acquisitions of applicable foreign corporation stock by foreign entities.

The stakeholder therefore recommended that, assuming a 10 percent de minimis partner threshold and a related-party requirement (discussed in part XVI.F.2 of this Explanation of Provisions), the domestic entity partner(s), rather than the foreign partnership, should be required (i) to determine the applicability of the stock repurchase excise tax, and (ii) to report and pay the stock repurchase excise tax on the full amount of the stock acquisition. The stakeholder noted that imposing the reporting and payment obligation on domestic entities does not raise the jurisdictional, enforcement, and collectability challenges that arise when such obligations are imposed on the foreign partnership, and that regulations could impose joint and several liability on the domestic entity partner(s). The stakeholder also recommended that the section 4501(d) proposed regulations provide procedures describing how a domestic entity may determine whether it holds the requisite ownership interest in a foreign partnership and whether the stock repurchase excise tax applies, and suggested rules similar to the safe harbor rules for determining whether a domestic entity holds an interest in a CFC in Rev. Proc. 2019–40, 2019–43 I.R.B. 982.

However, the stakeholder acknowledged that, if the 10 percent de minimis threshold and related-party requirements were not adopted, then a relatively small indirect domestic partner would not be able to file the stock repurchase excise tax return as it would be unlikely to have the requisite information. In the stakeholder's view, imposing the full excise tax on such partners would be unfair. Accordingly, the stakeholder recommended that, in this scenario, domestic partners only should be required to pay their allocable share of stock repurchase tax, although the stakeholder acknowledged that this approach could be complex and impracticable.

The Treasury Department and the IRS do not agree that the domestic entity partner should be required to file Form 720 and pay the section 4501(d) excise tax. Under the statute, the foreign partnership is the entity that is the applicable specified affiliate, which, in turn, is the entity that is liable for the section 4501(d) excise tax. The Treasury Department and the IRS continue to evaluate adding items relevant to the section 4501(d) excise tax to other existing tax return forms, including forms that at least certain domestic entity partners may otherwise be required to file.

Consequently, the section 4501(d) proposed regulations would not provide special filing or liability rules with respect to an applicable specified affiliate that is a foreign partnership with a direct or indirect domestic entity partner. Rather, such an applicable specified affiliate would be subject to the general requirements that apply to all entities that are section 4501(d) covered corporations.

The section 4501(d) proposed regulations also would not include diligence procedures for determining an entity's status as an applicable specified affiliate. The Treasury Department and the IRS are of the view that relevant diligence considerations may vary based on the particular facts and circumstances, and so specific

guidelines would be neither appropriate nor practical.

G. AFC Repurchases and CSFC Repurchases

Proposed § 58.4501–7(j) would provide rules for determining whether an acquisition by an applicable foreign corporation of its stock is an ''AFC repurchase'' and whether an acquisition by a covered surrogate foreign corporation of its stock is a ''CSFC repurchase'' for purposes of proposed § 58.4501–7. These rules are based on the rules in proposed § 58.4501–2(e) for determining whether a transaction is a repurchase for purposes of proposed § 58.4501–2. These rules are relevant for purposes of determining whether there is a covered purchase that could be subject to the proposed funding rule and whether a covered surrogate foreign corporation's repurchase of its stock is subject to section 4501(d)(2).

H. Date of Section 4501(d)(1) or Section 4501(d)(2) Repurchase; Fair Market Value of Stock

Proposed § 58.4501–7(k) would provide rules for determining the date on which a section 4501(d)(1) repurchase or a section 4501(d)(2) repurchase occurs. These proposed rules generally reflect the rules in proposed § 58.4501–2(g), except that the rule in proposed § 58.4501–7(k)(4) would provide that stock subject to a covered purchase to which the funding rule applies is treated as acquired by the applicable specified affiliate on the later of the date of the covered funding or the covered purchase. *See* part XVI.D.2.b of this Explanation of Provisions.

Proposed § 58.4501–7(l) would provide rules for determining the fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is subject to a section 4501(d)(1) repurchase or a section 4501(d)(2) repurchase. These rules generally follow the rules in proposed § 58.4501–2(h) for determining the fair market value of stock of a covered corporation that is repurchased.

I. Section 4501(d) Statutory Exceptions

1. In General

Section 4501(d) operates by modifying the general rules in section 4501(a) and (c). Because section 4501(d) operates in this manner, the section 4501(e) exceptions can be relevant to transactions subject to section 4501(d), except in one respect described in part XVI.I.2 of this Explanation of Provisions.

Proposed § 58.4501–7(m) would provide rules for determining the applicability of the statutory exceptions (section 4501(d) statutory exceptions), other than the section 4501(d) de minimis exception, to transactions that are subject to section 4501(d). The rules in proposed § 58.4501–7(m) are based on the rules in proposed § 58.4501–3, with certain modifications discussed in part XVI.I.2 of this Explanation of Provisions. For a discussion of the section 4501(d) de minimis exception, *see* part XVI.B.2 of this Explanation of Provisions.

2. Application of Section 4501(d) Statutory Exceptions

The section 4501(d) reorganization exception would apply only with respect to stock of an applicable foreign corporation repurchased in an AFC repurchase that is a section 4501(d)(1) repurchase and to stock of a covered surrogate foreign corporation repurchased in a CSFC repurchase that is a section 4501(d)(2) repurchase. *See* proposed § 58.4501–7(m)(2). The Treasury Department and the IRS are of the view that, based on the statutory language and the operation of section 4501(d), the relevant ''stock'' for purposes of applying the section 4501(d) reorganization exception is the stock of the applicable foreign corporation or the covered surrogate foreign corporation, as applicable. The references to ''stock'' in section 4501 refer to stock of the types of corporations subject to the excise tax that is repurchased or acquired—that is, covered corporations, applicable foreign corporations, and covered surrogate foreign corporations. Thus, the plain language of the statute demonstrates that ''stock'' for purposes of the section 4501(d) reorganization exception can only be stock of the applicable foreign corporation or covered surrogate corporation, as applicable. In accordance with this plain meaning, the Treasury Department and the IRS are of the view that the section 4501(d) reorganization exception only applies to repurchases and acquisitions of the equity of the corporation that is traded on an established securities market.

The stock contribution exception would apply only with respect to contributions of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, to an employer-sponsored retirement plan of the section 4501(d) covered corporation. *See* proposed § 58.4501–7(m)(3). The section 4501(d) proposed regulations would limit the employer-sponsored retirement plan exception to contributions to the employer-sponsored retirement plans of the section 4501(d) covered corporation to be consistent with the scope of the section 4501(d) netting rule, which only allows netting of stock provided by an applicable specified affiliate or an expatriated entity to its respective employees.

The section 4501(d) proposed regulations would apply the section 4501(e)(4) exception for certain repurchases by a dealer in securities in the ordinary course of the dealer's business based on the rules in proposed § 58.4501–3(e). *See* proposed § 58.4501–7(m)(4). For this purpose, the exception would apply to any repurchasing or acquiring entity that is a dealer in securities, whether such entity is an applicable foreign corporation, covered surrogate foreign corporation, or a specified affiliate of either.

The section 4501(d) proposed regulations would provide that the exception for RICs and REITs does not apply to a section 4501(d) repurchase or section 4501(d)(2) repurchase because each of an applicable foreign corporation or a covered surrogate foreign corporation will not qualify as a RIC or a REIT. *See* proposed § 58.4501–7(m)(5).

The dividend equivalence exception in proposed § 58.4501–7(m)(6) generally reflects the exception in proposed § 58.4501–3(g), including that the exception would apply to repurchases (as defined in proposed §§ 58.4501–2(e) and 58.4501–7(j)) but not to acquisitions by specified affiliates. However, with respect to the rebuttable presumption of no dividend equivalence, proposed § 58.4501–7(m)(6)(ii) would differ regarding how a section 4501(d) covered corporation may rebut the presumption, because section 4501(d) covered corporations are not the entities that are engaging in the repurchase for purposes of determining dividend equivalence. Further, unlike covered corporations, certain applicable foreign corporations or covered surrogate foreign corporations may not have relevant Federal income tax return filing requirements.

3. Feedback Received

One stakeholder requested clarification that the exceptions in section 4501(e) apply with respect to stock acquisitions or repurchases under section 4501(d). The section 4501(d) proposed regulations would implement that request in the manner described in part XVI.I.2 of this Explanation of Provisions.

One stakeholder recommended that, if an applicable specified affiliate uses stock of the applicable foreign corporation as consideration in a transaction, its acquisition of the

applicable foreign corporation stock should not be subject to section 4501(d)(1) as a matter of policy because the total amount of outstanding equity of the applicable foreign corporation would not be changed as a result of the two transactions taken together. The Treasury Department and the IRS are of the view that this recommendation is contrary to the plain language and statutory structure of section 4501(d)(1). However, in appropriate cases, transfers of applicable foreign corporation stock may qualify for a section 4501(d) statutory exception.

J. Section 4501(d) Netting Rule

1. Overview

Section 4501(d)(1)(C) and (d)(2)(C) provide that the adjustment in section 4501(c)(3) is determined only with respect to stock issued or provided by the section 4501(d) covered corporation to employees of the section 4501(d) covered corporation. Proposed § 58.4501–7(n) would provide rules for applying the section 4501(d) netting rule. Proposed § 58.4501–7(n) would clarify that the section 4501(d) netting rule applies only to stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, that is issued or provided by a section 4501(d) covered corporation to an employee in connection with the employee's performance of services in the employee's capacity as an employee of the section 4501(d) covered corporation.

These proposed rules are generally based on the rules in proposed § 58.4501–4, except that proposed § 58.4501–7(n) generally would incorporate the provisions of proposed § 58.4501–5 relating to the issuance or provision of stock to employees in connection with the performance of services.

2. Feedback Received

a. Relevant Stock

Section 6 of Notice 2023–2 requested comments on whether, for purposes of the section 4501(d) netting rule, there are any circumstances in which stock of the applicable specified affiliate or expatriated entity should be taken into account in addition to, or in lieu of, the stock of the applicable foreign corporation or covered surrogate foreign corporation, respectively.

One stakeholder recommended that, because the statute uses the term ''issued by,'' and an applicable specified affiliate or expatriated entity can issue only its own stock, stock of the applicable specified affiliate or expatriated entity, as applicable, should be taken into account for purposes of the section 4501(d) netting rule. The stakeholder also recognized that an applicable specified affiliate could provide the stock of the applicable foreign corporation to its employees, or an expatriated entity could provide the stock of the covered surrogate foreign corporation to its employees.

The Treasury Department and the IRS are of the view that, based on the statutory language, the relevant ''stock'' referenced in section 4501(d)(1)(C) and (d)(2)(C) is stock of the applicable foreign corporation and covered surrogate foreign corporation. All antecedent references to ''stock'' in section 4501(d) refer to stock of the applicable foreign corporation and covered surrogate foreign corporation. More broadly, all other references to ''stock'' in section 4501 refer to stock of the types of corporations subject to the excise tax that is repurchased or acquired—that is, covered corporations, applicable foreign corporations, and covered surrogate foreign corporations. Further, if an applicable specified affiliate or expatriated entity transfers to an employee treasury stock of an applicable foreign corporation or a covered surrogate foreign corporation, that transfer could be interpreted to constitute an issuance of that stock within the meaning of the statutory language.

Thus, the plain language of the statute demonstrates that ''stock'' for purposes of the section 4501(d) netting rule only can be stock of the applicable foreign corporation or covered surrogate corporation, as relevant. In accordance with this plain meaning, the Treasury Department and the IRS are of the view that the section 4501(d) netting rule functions to tailor the section 4501(d) excise tax base to the net reduction of the equity of the corporation that is traded on an established securities market.

Further, the stakeholder acknowledged that, under its recommendation, a partnership that is a section 4501(d) covered corporation would be unable to qualify for the section 4501(d) netting rule with respect to its equity because partnership interests are not ''stock.'' However, this discontinuity in the application of the section 4501(d) netting rule would be avoided if ''stock'' is interpreted to refer to stock of an applicable foreign corporation or a covered surrogate foreign corporation.

The stakeholder further acknowledged that allowing netting under the section 4501(d) netting rule for stock of a section 4501(d) covered corporation would permit the section 4501(d) covered corporation to redeem any such issued stock without application of section 4501 (assuming the applicable specified affiliate or expatriated entity is not itself a covered corporation). The Treasury Department and the IRS are of the view that it is not appropriate to allow stock issuances by section 4501(d) covered corporations to reduce the section 4501(d) excise tax base if the repurchase or acquisition of that stock would not be subject to section 4501.

Accordingly, the section 4501(d) proposed regulations would provide that only stock of the applicable foreign corporation or covered surrogate foreign corporation, as appropriate, is taken into account for purposes of the section 4501(d) netting rule. *See* proposed § 58.4501–7(n)(1).

b. Stock Issued or Provided by Specified Affiliates

The section 4501(d) netting rule would apply only with respect to stock issued or provided by the section 4501(d) covered corporation to employees (in connection with the performance of services) of the section 4501(d) covered corporation. *See* proposed § 58.4501–7(n)(1). However, stakeholders recommended that, if the Notice funding rule applies to treat an applicable specified affiliate as acquiring the stock of the applicable foreign corporation when it funds the applicable foreign corporation's repurchase, the proposed regulations also should provide that the section 4501(d) netting rule applies at least to some degree with respect to stock issued or provided by the applicable foreign corporation to employees of the applicable foreign corporation.

The Treasury Department and the IRS are of the view that such a modification would be inappropriate. The proposed funding rule is intended to prevent an applicable specified affiliate from avoiding the section 4501(d) excise tax through funding transactions. Therefore, the section 4501(d) proposed regulations should not provide for such an expansion of the section 4501(d) netting rule if the funding rule applies. Furthermore, the Treasury Department and the IRS are of the view that this requested modification to the section 4501(d) netting rule is unwarranted given the narrower scope of the proposed funding rule relative to the Notice funding rule.

One stakeholder also requested clarification as to whether the section 4501(d) netting rule is applied on an entity-by-entity basis or on an aggregate basis. Under an entity-by-entity approach, the section 4501(d) netting

rule would be applied separately to each section 4501(d) covered corporation. In contrast, under an aggregate approach, the modified netting rule would be applied on an aggregate basis to all section 4501(d) covered corporations. The stakeholder expressed the view that the entity-by-entity approach arguably is more consistent with the statutory language of the section 4501(d) netting rule, but that the aggregate approach would better achieve the anti-dilutive policy focus of the stock repurchase excise tax and simplify compliance.

The Treasury Department and the IRS agree with the stakeholder that the entity-by-entity approach follows the statutory language of the section 4501(d) netting rule. Section 4501(d)(1)(C) and (d)(2)(C) require the section 4501(d) netting rule to apply ''only'' with respect to stock issued or provided by ''such'' applicable specified affiliate or expatriated entity. Therefore, the Treasury Department and the IRS are of the view that the statute provides for an entity-by-entity approach. Furthermore, the Treasury Department and the IRS are of the view that it is not appropriate to expand the section 4501(d) netting rule beyond that statutory scope.

c. Employee-Related Issues

One stakeholder recommended that, for purposes of applying the section 4501(d) netting rule, employee status alone should be sufficient, and there should be no requirement that the stock be issued or provided to the employee in connection with the performance of services.

The Treasury Department and the IRS do not agree with the stakeholder. The reference in the statue to ''employees'' is most naturally read to refer to employees in their capacity as employees providing services to their employer. The requirement that the stock be issued in connection with the performance of services also would prevent potential abuse in situations in which a company could make an individual into a nominal employee and then allow the individual to acquire stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable.

In addition, the issuance or provision of an instrument that is not in the legal form of stock generally is disregarded for purposes of the section 4501(d) netting rule. An exception is provided if such an instrument is repurchased or acquired in a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, but only if such instrument is issued or provided by the section 4501(d) covered corporation to its employees. The Treasury Department and the IRS are of the view that it is unlikely that an applicable specified affiliate would issue or provide an instrument that is not in the legal form of stock to its employees in connection with the employee's performance of services in its capacity as an employee. The Treasury Department and the IRS request comments on whether this provision should be retained, deleted, or modified to reflect actual practices of applicable specified affiliate issuing or providing instruments that are not in the legal form of stock as compensation for an employee's performance of services.

In section 6 of Notice 2023–2, the Treasury Department and the IRS also requested comments on whether, in cases in which a foreign partnership is the applicable specified affiliate, stock issued or provided to any employees of the foreign partnership should be taken into account, or whether the section 4501(d) netting rule should be applied to stock issued or provided only to employees of the domestic entity that is a direct or indirect partner.

One stakeholder recommended against adopting an approach that would distinguish between the treatment of domestic and foreign partnerships that are applicable specified affiliates because that approach would be inconsistent with the statute, which does not make that type of distinction.

The Treasury Department and the IRS agree with the stakeholder that the section 4501(d) proposed regulations should not distinguish between the treatment of domestic partnership and foreign partnerships in this respect for purposes of the section 4501(d) netting rule. Furthermore, section 4501(d)(1)(C) and (d)(2)(C) apply the section 4501(d) netting rule to ''employees *of* the specified affiliate'' and ''employees *of* the expatriated entity'' (*emphasis added*). The statute thus provides for netting with respect to stock issued or provided to employees of the applicable specified affiliate or the expatriated entity itself, and not to employees of partners or shareholders of the applicable specified affiliate or expatriated entity.

K. Rules Applicable Before April 13, 2024

Proposed § 58.4501–7(o) would provide rules that track section 3.05(2) of Notice 2023–2 and that would apply to transactions occurring on or after December 31, 2022, and before April 12, 2024. *See* proposed § 58.4501–7(r)(2). A section 4501(d) covered corporation may generally choose, in lieu of applying proposed § 58.4501–7(o) to this period, to apply the section 4501(d) proposed regulations (other than proposed §§ 58.4501–7(o) and (r)(1)–(2)), as finalized. *See* proposed § 58.4501–7(r)(3). Thus, a section 4501(d) covered corporation would have this option not to apply the rules in proposed § 58.4501–7(o) to any period. *See* part XVI.L of this Explanation of Provisions (discussion of applicability dates for proposed § 58.4501–7).

L. Applicability Dates

Proposed § 58.4501–7(r)(1) would provide that the section 4501(d) proposed regulations (other than proposed § 58.4501–7(o)) generally apply to transactions occurring after April 12, 2024. *See* section 7805(b)(1)(B) of the Code. Transactions would include a covered purchase after that date to which a covered funding that occurred on or after December 27, 2022, and on or before April 12, 2024 is allocated. *See* proposed § 58.4501–7(e)(1).

Proposed § 58.4501–7(r)(2) would provide that proposed § 58.4501–7(o) applies to transactions occurring on or after December 31, 2022, and on or before April 12, 2024. *See* section 7805(b)(1)(C). Transactions would include a covered purchase during this period that is funded by a funding that occurred on or after December 27, 2022, and on or before April 12, 2024. *See* proposed § 58.4501–7(o)(2).

Proposed § 58.4501–7(r)(3) would provide that a section 4501(d) covered corporation may generally choose instead to apply the section 4501(d) proposed regulations (other than proposed §§ 58.4501–7(o) and (r)(1)–(2)), as finalized, with respect to transactions occurring after December 31, 2022, subject to a consistency requirement. Transactions would include a covered purchase after December 31, 2022, to which a covered funding that occurred on or after December 27, 2022, is allocated. *See* proposed § 58.4501–7(e)(1).

XVII. Procedure and Administration

Subpart B of part 58, as proposed elsewhere in this issue of the **Federal Register**, would add rules on procedure and administration under sections 6001, 6011, 6060, 6061, 6065, 6071, 6091, 6107, 6109, 6151, 6694, 6695, and 6696 of the Code to prescribe the manner and method of reporting and paying the stock repurchase excise tax.

Effect on Other Documents

Notice 2023–2, 2023–3 I.R.B. 374, is obsoleted for repurchases, issuances, and provisions of stock of a covered

corporation occurring after April 12, 2024.

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA) requires that a Federal agency obtain the approval of the Office of Management and Budget (OMB) before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit.

The collections of information in these proposed regulations contain reporting, third-party disclosure, and recordkeeping requirements in §§ 58.4501–2(j)(6) and 58.4501–7(e)(2). This information is necessary for the IRS to accurately determine the stock repurchase excise tax due and is required by law to comply with the provisions of section 4501 of the Code as enacted by section 10201 of the Inflation Reduction Act of 2022. A Federal agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The recordkeeping requirements mentioned within these proposed regulations are considered general tax records under section 6001. These records are required for the IRS to validate that taxpayers have met the regulatory requirements and are required as proof of their qualification for an exception to the stock repurchase excise tax. For PRA purposes, general tax records are already approved by OMB under 1545–0123 for business filers and 1545–0074 for individual filers.

The reporting and third-party disclosure requirements will be covered within Form 7208 and its instructions. The IRS is seeking OMB approval and requesting a new OMB control number for Form 7208 in accordance with the procedures outlined in 5 CFR 1320.10.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these proposed regulations apply only to publicly traded corporations, which tends to consist of larger businesses. Specifically, based on data available to the IRS, for tax year 2021, 4,366 corporations reported publicly traded common stock. Of those corporations, 2,407 (over 55 percent) reported gross receipts over $100 million, and 3,272 (approximately 75 percent) reported gross receipts over $10 million. Meanwhile, for tax year 2021, the IRS received 7,464,790 Corporation Income Tax Returns and 4,710,457 U.S. Returns of Partnership Income. IRS Publication 6292, Fiscal Year Projections for the United States: 2022–2029, Fall 2022, Table 2. Of these corporation and partnership returns for tax year 2021, 11,685,207 reported total assets below $10 million. Thus, the number of corporations affected by these proposed regulations that reported total assets below $10 million is less than one hundredth of one percent of the total number of businesses that reported total assets below $10 million for tax year 2021. Therefore, these proposed regulations will not create additional obligations for, or impose an economic impact on, a substantial number of small entities. Accordingly, the Secretary certifies that the proposed regulations will not have a significant economic impact on a substantial number of small entities and a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

IV. Section 7805(f)

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation.

These proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations, including on forms related to the proposed regulations. In addition, the Treasury Department and the IRS request comments on the specific requests made in the Explanation of Provisions. All commenters are strongly encouraged to submit comments electronically. The Treasury Department and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket on *https://www.regulations.gov.*

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are encouraged to be made electronically. If a public hearing is scheduled, a notice of the date and time for the public hearing will be published in the **Federal Register**.

Statement of Availability of IRS Documents

Any IRS Revenue Procedure, Revenue Ruling, Notice, or other guidance cited in this document is published in the Internal Revenue Bulletin (or Cumulative Bulletin) and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov.*

Drafting Information

The principal authors of these proposed regulations are Samuel G. Trammell of the Office of Associate Chief Counsel (Corporate), Naomi Lehr of the Office of Associate Chief Counsel

(Employee Benefits, Exempt Organizations, and Employment Taxes), Jonathan A. LaPlante of the Office of Associate Chief Counsel (Financial Institutions and Products), and Brittany N. Dobi of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 58

Excise taxes, Stock repurchase excise tax, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR chapter 1 as follows:

PART 1—INCOME TAX

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.1275–6 is amended by adding paragraph (f)(12)(iii) to read as follows:

§ 1.1275–6 Integration of qualifying debt instruments.

* * * * *

(f) * * *

(12) * * *

(iii) *Excise tax on repurchase of corporate stock.* If a taxpayer enters into an integrated transaction (for example, a convertible debt instrument integrated with one or more § 1.1275–6 hedges consisting of an option on the taxpayer's own stock), then, solely for purposes of section 4501 of the Code and the stock repurchase excise tax regulations (as defined in § 58.4501–1(b)(30) of this chapter), the taxpayer must apply the rules that would apply on a separate basis to the components of the integrated transaction rather than the rules that otherwise would apply to the integrated transaction under this section. Notwithstanding paragraph (j) of this section, this paragraph (f)(12)(iii) applies to an integrated transaction outstanding after December 31, 2022 (regardless of when such integrated transaction was entered into by the taxpayer).

* * * * *

■ **Par. 3.** Add part 58 to read as follows:

PART 58—STOCK REPURCHASE EXCISE TAX

Subpart A—Excise Tax on Stock Repurchases

Sec.

Subpart B [Reserved]

Authority: 26 U.S.C. 4501(f) and 7805.

Subpart A—Excise Tax on Stock Repurchases

§ 58.4501–0 Table of contents.

This section lists the major captions that appear in §§ 58.4501–1 through 58.4501–7.

§ 58.4501–1 Excise tax on stock repurchases.

(a) *Excise tax imposed.* Section 4501(a) of the Code imposes on each covered corporation an excise tax (stock repurchase excise tax) equal to the applicable percentage of the fair market value of any stock of the corporation that is repurchased by the corporation during the taxable year. This section and § 58.4501–2 provide generally applicable definitions and operating rules regarding the application of the stock repurchase excise tax and the computation of the stock repurchase excise tax liability of a covered corporation. Section 58.4501–3 provides rules regarding the application of the exceptions in section 4501(e) (other than the de minimis exception described in section 4501(e)(3), which is addressed in § 58.4501–2(b)(2)), and § 58.4501–4 provides rules regarding the application of section 4501(c)(3). Section 58.4501–5 provides examples that illustrate the application of section 4501 and the stock repurchase excise tax regulations. Section 58.4501–6 provides applicability dates for the stock repurchase excise tax regulations (other than § 58.4501–7). For special rules and examples regarding the application of section 4501(d) to acquisitions or repurchases of stock of certain foreign corporations, see § 58.4501–7.

(b) *Definitions.* The following definitions apply for purposes of this section and 58.4501–2 through 58.4501–6, and, to the extent provided in § 58.4501–7, for purposes of § 58.4501–7:

(1) *Acquisitive reorganization.* The term *acquisitive reorganization* means a transaction that qualifies as a reorganization under—

(i) Section 368(a)(1)(A) of the Code (A reorganization) (including by reason of section 368(a)(2)(D) or section 368(a)(2)(E) (reverse triangular merger));

(ii) Section 368(a)(1)(C);

(iii) Section 368(a)(1)(D) (D reorganization) (if the D reorganization satisfies the requirements of section 354(b)(1) of the Code); or

(iv) Section 368(a)(1)(G) (if the reorganization satisfies the requirements of section 354(b)(1)).

(2) *Applicable percentage.* The term *applicable percentage* means the percentage provided in section 4501(a).

(3) *Cessation date.* The term *cessation date* means the date on which all stock of a covered corporation ceases to be traded on an established securities market.

(4) *Clawback.* The term *clawback* means a surrender of stock pursuant to a contractual provision that requires an employee to return vested stock.

(5) *Controlled corporation.* The term *controlled corporation* has the meaning given the term in section 355(a)(1)(A) of the Code.

(6) *Covered corporation.* The term *covered corporation* means any domestic corporation (including within the meaning of paragraph (f) of this section) the stock of which is traded on an established securities market.

(7) *De minimis exception.* The term *de minimis exception* has the meaning given the term in § 58.4501–2(b)(2)(i).

(8) *Distributing corporation.* The term *distributing corporation* has the meaning given the term in section 355(a)(1)(A).

(9) *Economically similar transaction.* The term *economically similar transaction* means a transaction described in § 58.4501–2(e)(4).

(10) *Employee.* The term *employee* means an employee as defined in section 3401(c) of the Code and § 31.3401(c)-1 of this chapter, or a former employee, of the covered corporation or specified affiliate (as appropriate).

(11) *Employer-sponsored retirement plan*—(i) *In general.* The term *employer-sponsored retirement plan* means a retirement plan that is qualified under section 401(a) of the Code and maintained by a covered corporation or a specified affiliate of the covered corporation.

(ii) *ESOPs included.* The term *employer-sponsored retirement plan* includes an employee stock ownership plan described in section 4975(e)(7) of the Code (ESOP) that is maintained by a covered corporation or a specified affiliate of the covered corporation.

(12) *E reorganization.* The term *E reorganization* means a transaction that qualifies as a reorganization under section 368(a)(1)(E).

(13) *Established securities market.* The term *established securities market* has the meaning given the term in § 1.7704–1(b) of this chapter.

(14) *F reorganization.* The term *F reorganization* means a transaction that qualifies as a reorganization under section 368(a)(1)(F).

(15) *Forfeiture.* The term *forfeiture* means a surrender of stock to the issuing corporation for no consideration.

(16) *Initiation date.* The term *initiation date* means the date on which stock of a corporation begins to be traded on an established securities market.

(17) *IRS.* The term *IRS* means the Internal Revenue Service.

(18) *Netting rule.* The term *netting rule* has the meaning given the term in § 58.4501–4(a).

(19) *Qualifying property repurchase.* The term *qualifying property repurchase* has the meaning given the term in § 58.4501–3(c).

(20) *REIT.* The term *REIT* has the meaning given the term *real estate investment trust* in section 856(a) of the Code.

(21) *Reorganization exception.* The term *reorganization exception* has the meaning given the term in § 58.4501–3(c).

(22) *Repurchase.* The term *repurchase* has the meaning given the term in § 58.4501–2(e)(2).

(23) *RIC.* The term *RIC* has the meaning given the term *regulated investment company* in section 851 of the Code.

(24) *Section 317(b) redemption.* The term *section 317(b) redemption* means a redemption within the meaning of section 317(b) of the Code with regard to the stock of a covered corporation.

(25) *Specified affiliate.* The term *specified affiliate* means, with regard to any corporation—

(i) Any corporation more than 50 percent of the stock of which is owned (by vote or by value), directly or indirectly, by the corporation; and

(ii) Any partnership more than 50 percent of the capital interests or profits interests of which is held, directly or indirectly, by the corporation.

(26) *Split-off.* The term *split-off* means a distribution qualifying under section 355 (or so much of section 356 of the Code as relates to section 355) by a distributing corporation pursuant to which the shareholders of the distributing corporation exchange stock of the distributing corporation for stock of the controlled corporation and, if applicable, other property (including securities of the controlled corporation) or money.

(27) *Statutory exception.* The term *statutory exception* has the meaning given the term in § 58.4501–3(a).

(28) *Statutory references.* For purposes of this part—

(i) The term *chapter 1* means chapter 1 of the Code; and

(ii) The term *Code* means the Internal Revenue Code.

(29) *Stock*—(i) *In general.* The term *stock* means any instrument issued by a corporation that is stock (including treasury stock) or that is treated as stock for Federal tax purposes at the time of issuance, regardless of whether the instrument is traded on an established securities market.

(ii) *Additional tier 1 capital.* The term *stock* does not include preferred stock that—

(A) Qualifies as additional tier 1 capital (within the meaning of 12 CFR 3.20(c), 217.20(c), or 324.20(c)); and

(B) Does not qualify as common equity tier 1 capital (within the meaning of 12 CFR 3.20(b), 217.20(b), or 324.20(b)).

(30) *Stock repurchase excise tax.* The term *stock repurchase excise tax* has the meaning given the term in paragraph (a) of this section.

(31) *Stock repurchase excise tax base.* The term *stock repurchase excise tax base* has the meaning given the term in § 58.4501–2(c)(1).

(32) *Stock repurchase excise tax regulations.* The term *stock repurchase excise tax regulations* means the following provisions of 26 CFR chapter I:

(i) Subpart A of this part, which consists of this section and §§ 58.4501–2 through 58.4501–7.

(ii) Subpart B of this part.

(iii) Section 1.1275–6(f)(12)(iii) of this chapter, which provides that the integration of a qualifying debt instrument with a hedge pursuant to § 1.1275–6 of this chapter is not taken into account in determining whether and when stock is repurchased or issued.

(33) *Taxable year.* The term *taxable year* has the meaning given the term in section 7701(a)(23) of the Code.

(34) *Treasury stock.* The term *treasury stock* means treasury stock within the meaning of section 317(b).

(c) *No application for any purposes of chapter 1.* The rules of this part have no application for purposes of chapter 1.

(d) *Status as a domestic or foreign corporation.* If a corporation is, or is treated as, a domestic corporation for purposes of the Code or for purposes that include chapter 37 of the Code, then the corporation is a domestic corporation for purposes of the stock repurchase excise tax regulations. A corporation that is not a domestic corporation for purposes of the stock repurchase excise tax regulations is a foreign corporation for such purposes.

§ 58.4501–2 General rules regarding excise tax on stock repurchases.

(a) *Scope.* This section provides general rules regarding the application of the stock repurchase excise tax and the computation of the stock repurchase excise tax liability of a covered corporation. Paragraphs (b) and (c) of this section provide rules for computing a covered corporation's stock repurchase excise tax liability. Paragraph (d) of this section provides rules for determining whether a corporation is a covered corporation. Paragraph (e) of this section provides rules for determining whether a transaction is a repurchase. Paragraph (f) of this section provides rules for acquisitions of stock of a covered corporation by a specified affiliate of the covered corporation. Paragraph (g) of this section provides rules for determining when stock is repurchased. Paragraph (h) of this section provides rules for determining the fair market value of repurchased stock.

(b) *Computation of excise tax liability*—(1) *Imposition of tax.* Except as provided in paragraph (b)(2) of this section (regarding the de minimis exception), the amount of stock repurchase excise tax imposed on a covered corporation for a taxable year equals the product obtained by multiplying—

(i) The applicable percentage; by

(ii) The stock repurchase excise tax base of the covered corporation for the taxable year determined in accordance with paragraph (c)(1) of this section.

(2) *De minimis exception*—(i) *In general.* A covered corporation is not subject to the stock repurchase excise tax with regard to a taxable year if, during that taxable year, the aggregate fair market value of the stock described in paragraphs (b)(2)(i)(A) and (B) of this section does not exceed $1,000,000 (de minimis exception):

(A) The stock of the covered corporation that is repurchased by the covered corporation.

(B) The stock of the covered corporation that is acquired by a specified affiliate of the covered corporation.

(ii) *Determination.* A determination of whether the de minimis exception applies with regard to a taxable year is made before applying—

(A) Any statutory exception under § 58.4501–3; and

(B) Any adjustments pursuant to the netting rule under § 58.4501–4.

(c) *Stock repurchase excise tax base*—(1) *In general.* With regard to a covered corporation, the term *stock repurchase excise tax base* means the dollar amount (not less than zero) that is obtained by—

(i) Determining (in accordance with paragraphs (e) through (h) of this section) the aggregate fair market value of—

(A) The stock of the covered corporation that is repurchased by the covered corporation during the covered corporation's taxable year; and

(B) The stock of the covered corporation that is acquired by a specified affiliate of the covered corporation during the covered corporation's taxable year;

(ii) Reducing the amount determined under paragraph (c)(1)(i) of this section by the fair market value of the stock of the covered corporation repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation during the covered corporation's taxable year to the extent any statutory exceptions apply in accordance with § 58.4501–3; and then

(iii) Reducing the amount determined under paragraphs (c)(1)(i) and (ii) of this section by the aggregate fair market value of stock of the covered corporation issued by the covered corporation, or provided by a specified affiliate of the covered corporation, during the covered corporation's taxable year under the netting rule in accordance with § 58.4501–4.

(2) *Taxable year determination*—(i) *In general.* The determinations under paragraph (c)(1)(i) of this section are made separately for each covered corporation and for each taxable year of the covered corporation.

(ii) *No carrybacks or carryforwards.* Reductions under paragraphs (c)(1)(ii) and (iii) of this section in excess of the amount determined under paragraph (c)(1)(i) of this section with regard to a

covered corporation are not carried forward or backward to preceding or succeeding taxable years of the covered corporation.

(3) *Repurchases before January 1, 2023.* Stock of a covered corporation repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation before January 1, 2023 (as determined under paragraphs (e) through (g) of this section) is neither—

(i) Included in the stock repurchase excise tax base of the covered corporation; nor

(ii) Taken into account in determining the applicability of the de minimis exception.

(d) *Duration of covered corporation status*—(1) *Initiation date.* A corporation becomes a covered corporation at the beginning of the corporation's initiation date.

(2) *Cessation date*—(i) *In general.* Except as provided in paragraph (d)(2)(ii) of this section, a corporation ceases to be a covered corporation at the end of the corporation's cessation date.

(ii) *Repurchases after cessation date.* If a corporation ceases to be a covered corporation pursuant to a plan that includes a repurchase, and if the cessation date precedes the date on which any repurchase undertaken pursuant to the plan occurs (for example, if stock of a covered corporation ceases trading prior to completion of an acquisitive reorganization), then the corporation will continue to be a covered corporation with regard to each repurchase pursuant to the plan until the end of the date on which the last repurchase pursuant to the plan occurs.

(3) *Inbound and outbound F reorganizations*—(i) *Inbound F reorganization.* In the case of a foreign corporation that transfers its assets or that is treated as transferring its assets to a domestic corporation in an F reorganization (as described in § 1.367(b)–2(f) of this chapter), the corporation is not treated as a domestic corporation until the day after the reorganization.

(ii) *Outbound F reorganization.* In the case of a domestic corporation that transfers its assets or that is treated as transferring its assets to a foreign corporation in an F reorganization (as described in § 1.367(a)–1(e) of this chapter), the corporation is not treated as a foreign corporation until the day after the reorganization.

(e) *Repurchase*—(1) *Overview.* This paragraph (e) provides rules for determining whether a transaction is a repurchase. Paragraph (e)(2) of this section provides a general rule regarding the scope of the term *repurchase.* Paragraph (e)(3) of this section provides an exclusive list of transactions that are treated as a section 317(b) redemption but are not a repurchase. Paragraph (e)(4) of this section provides an exclusive list of transactions that are economically similar transactions. Paragraph (e)(5) of this section provides a non-exclusive list of transactions that are not repurchases. Paragraph (f) of this section provides rules regarding acquisitions of covered corporation stock by specified affiliates.

(2) *Scope of repurchase.* A *repurchase* means solely—

(i) A section 317(b) redemption, except as provided in paragraph (e)(3) of this section; or

(ii) An economically similar transaction described in paragraph (e)(4) of this section.

(3) *Certain section 317(b) redemptions that are not repurchases.* This paragraph (e)(3) provides an exclusive list of transactions that are section 317(b) redemptions but are not repurchases.

(i) *Section 304(a)(1) transactions*—(A) *Rule regarding deemed distributions.* If section 304(a)(1) of the Code applies to an acquisition of stock by an acquiring corporation (within the meaning of section 304(a)(1)), the acquiring corporation's deemed distribution in redemption of the acquiring corporation's stock (resulting from the application of section 304(a)(1)) is not a repurchase.

(B) *Scope of rule.* The rule described in paragraph (e)(3)(i)(A) of this section applies to a transaction described in paragraph (e)(3)(i)(A) of this section regardless of whether section 302(a) or (d) of the Code applies to the acquiring corporation's deemed distribution in redemption of its stock.

(C) *Rule regarding deemed issuances.* For the rule addressing the treatment of any stock deemed to be issued by the acquiring corporation as a result of the application of section 304(a)(1), *see* § 58.4501–4(f)(4).

(ii) *Payment by a covered corporation of cash in lieu of fractional shares.* A payment by a covered corporation of cash in lieu of a fractional share of the covered corporation's stock is not a repurchase if—

(A) The payment is carried out as part of a transaction that qualifies as a reorganization under section 368(a) or a distribution to which section 355 applies, or pursuant to the settlement of an option or similar financial instrument (for example, a convertible debt instrument or convertible preferred share);

(B) The cash received by the shareholder entitled to the fractional share is not separately bargained-for consideration (that is, the cash paid by the covered corporation in lieu of the fractional share represents a mere rounding off of the shares issued in the exchange or settlement);

(C) The payment is carried out solely for administrative convenience (and, therefore, solely for non-tax reasons); and

(D) The amount of cash paid to the shareholder in lieu of a fractional share does not exceed the fair market value of one full share of the class of stock of the covered corporation with respect to which the payment of cash in lieu of a fractional share is made.

(4) *Economically similar transactions.* This paragraph (e)(4) provides an exclusive list of transactions that are economically similar transactions. For rules regarding the statutory exceptions, *see* § 58.4501–3.

(i) *Acquisitive reorganizations.* In the case of an acquisitive reorganization in which the target corporation is a covered corporation, the exchange by the target corporation shareholders of their target corporation stock pursuant to the plan of reorganization is a repurchase by the target corporation.

(ii) *E reorganizations.* In the case of an E reorganization in which the recapitalizing corporation is a covered corporation, the exchange by the recapitalizing corporation shareholders of their recapitalizing corporation stock pursuant to the plan of reorganization is a repurchase by the recapitalizing corporation.

(iii) *F reorganizations.* In the case of an F reorganization in which the transferor corporation (as defined in § 1.368–2(m)(1) of this chapter) is a covered corporation, the exchange by the transferor corporation shareholders of their transferor corporation stock pursuant to the plan of reorganization is a repurchase by the transferor corporation.

(iv) *Split-offs.* In the case of a split-off by a distributing corporation that is a covered corporation, the exchange by the distributing corporation shareholders of their distributing corporation stock is a repurchase by the distributing corporation.

(v) *Complete liquidations to which both sections 331 and 332 apply.* In the case of a complete liquidation of a covered corporation to which sections 331 and 332(a) of the Code respectively apply to component distributions of the complete liquidation—

(A) Each distribution to which section 331 applies is a repurchase by the covered corporation; and

(B) The distribution to which section 332(a) applies is not a repurchase by the

covered corporation (*see* paragraph (e)(5)(i)(A) of this section).

(vi) *Certain forfeitures and clawbacks of stock*—(A) *In general.* In the case of a forfeiture or clawback of stock of a covered corporation pursuant to a legal or contractual obligation, the forfeiture or clawback is a repurchase by the covered corporation or acquisition by a specified affiliate of the covered corporation (as appropriate) on the date of forfeiture or clawback (as appropriate) if the stock was treated as issued or provided under § 58.4501–4(b) and the forfeiture or clawback of the stock (as appropriate) is described in paragraph (e)(4)(vi)(B), (C), or (D) of this section.

(B) *Stock subject to post-closing price adjustments.* The stock was issued pursuant to an acquisition of a target entity or its business, and the forfeiture of the stock was in accordance with the terms of the documents governing the transaction (for example, to compensate the acquiring corporation for breaches of representations or warranties made by the target entity, or because the business of the target entity did not achieve certain performance benchmarks agreed upon in the transaction documents).

(C) *Stock for which a section 83(b) election was made.* The stock was subject to a substantial risk of forfeiture within the meaning of section 83(a) of the Code on the date the stock was issued or provided, the service provider made a valid election under section 83(b) with regard to the stock, and the forfeiture resulted from the service provider failing to meet the vesting condition.

(D) *Clawbacks.* On the date the stock was issued or provided, the stock was subject to a clawback agreement, and a clawback of the stock resulted from the occurrence of an event specified in the clawback agreement.

(5) *Transactions that are not repurchases.* This paragraph (e)(5) provides a non-exclusive list of transactions that are not repurchases.

(i) *Complete liquidations generally.* Except as provided in paragraph (e)(4)(v)(A) of this section, the following is not a repurchase by a covered corporation:

(A) A distribution in complete liquidation of the covered corporation to which section 331 or 332(a) applies.

(B) A distribution pursuant to the resolution or plan of dissolution of the covered corporation that is reported on the original (but not a supplemented or an amended) IRS Form 966, *Corporate Dissolution or Liquidation* (or any successor form).

(C) A distribution pursuant to a deemed dissolution of the covered corporation (for instance, pursuant to a deemed liquidation under § 301.7701–3 of this chapter).

(ii) *Distributions during taxable year of complete liquidation or dissolution.* Unless paragraph (e)(4)(v) of this section applies, no distribution by a covered corporation during a taxable year of the covered corporation is a repurchase by the covered corporation if the covered corporation—

(A) Completely liquidates during the taxable year (that is, has a final distribution during the taxable year in a complete liquidation to which section 331 applies);

(B) Dissolves during the taxable year pursuant to the resolution or plan of dissolution as reported on the original (but not a supplemented or an amended) IRS Form 966, *Corporate Dissolution or Liquidation* (or any successor form); or

(C) Is deemed to dissolve during the taxable year (for instance, pursuant to a deemed liquidation under § 301.7701–3 of this chapter).

(iii) *Divisive transactions under section 355 other than split-offs*—(A) *In general.* Subject to paragraph (e)(5)(iii)(B) of this section, a distribution by a distributing corporation that is a covered corporation of stock of a controlled corporation qualifying under section 355 that is not a split-off is not a repurchase by the distributing corporation.

(B) *Exception regarding non-qualifying property in spin-offs.* A distribution by a distributing corporation that is a covered corporation of other property or money in exchange for stock of the distributing corporation is a repurchase by the distributing corporation if it occurs in pursuance of a transaction qualifying under section 355 in which the distribution by the distributing corporation of stock of the controlled corporation is with respect to stock of the distributing corporation.

(iv) *Non-redemptive distributions subject to section 301(c)(2) or (3).* A distribution to which section 301 of the Code applies by a covered corporation to a distributee is not a repurchase by the covered corporation if the distribution—

(A) Is subject to section 301(c)(2) or (3); and

(B) The distributee does not exchange stock of the covered corporation (and is not treated as exchanging stock of the covered corporation for Federal income tax purposes).

(v) *Net cash settlement of an option contract or other derivative financial instrument.* The net cash settlement of an option contract or other derivative financial instrument with respect to stock of a covered corporation is not a repurchase by the covered corporation. The net cash settlement of an instrument in the legal form of an option contract or other derivative financial instrument that is treated as stock for Federal tax purposes at the time of issuance is treated as a repurchase of that instrument, and therefore a repurchase by the covered corporation.

(f) *Acquisitions by specified affiliates*—(1) *Acquisitions of stock of a covered corporation by a specified affiliate treated as a repurchase.* If a specified affiliate of a covered corporation acquires stock of the covered corporation from a person that is not the covered corporation or another specified affiliate of the covered corporation, the acquisition is treated as a repurchase of the stock of the covered corporation by the covered corporation.

(2) *Determination of specified affiliate status*—(i) *Timing of determination.* A covered corporation must determine if another corporation or a partnership is a specified affiliate of the covered corporation if the determination is relevant for purposes of computing the stock repurchase excise tax with regard to the covered corporation.

(ii) *Indirect ownership.* For purposes of determining whether a corporation or a partnership is a specified affiliate of a covered corporation, the covered corporation is treated as indirectly owning stock in the corporation or holding capital or profits interests in the partnership in the percentage equal to the covered corporation's proportionate percentage of stock owned, or capital or profits interests held, through other entities.

(3) *Constructive specified affiliate acquisition*—(i) *General rule.* Except as provided in paragraph (f)(3)(ii) of this section, shares of stock of a covered corporation are treated as repurchased by the covered corporation if—

(A) A corporation or a partnership becomes a specified affiliate of the covered corporation;

(B) At the time the corporation or partnership becomes a specified affiliate of the covered corporation, the corporation or partnership owns such shares, and such shares represent more than one percent of the fair market value of the assets of the corporation or partnership as determined at such time; and

(C) The corporation or partnership acquired such shares after December 31, 2022.

(ii) *Stock previously treated as repurchased not subject to deemed repurchase more than once.* Paragraph

(f)(3)(i) of this section does not apply with regard to any shares of stock of a covered corporation—

(A) Held by the corporation or partnership described in paragraph (f)(3)(i) of this section at the time that it becomes a specified affiliate of the covered corporation; and

(B) That the covered corporation identifies as previously having been treated as repurchased by the covered corporation under paragraph (f)(3)(i) of this section when held by the corporation or partnership.

(iii) *Specific identification.* For purposes of paragraphs (f)(3)(i) and (ii) of this section, if the corporation or partnership described in paragraph (f)(3)(i) of this section is unable to specifically identify which shares of stock of the covered corporation the corporation or partnership is treated as holding at the time it becomes a specified affiliate of the covered corporation, the covered corporation must treat the corporation or partnership as holding the most recently acquired shares of the stock of the covered corporation.

(g) *Date of repurchase*—(1) *General rule.* In general, stock of a covered corporation is treated as repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation on the date on which ownership of the stock transfers to the covered corporation or specified affiliate (as appropriate) for Federal income tax purposes. To determine the date of repurchase in particular situations, *see* paragraphs (g)(2), (3), and (4) of this section.

(2) *Regular-way sale.* A regular-way sale of stock of a covered corporation (that is, a transaction in which a trade order is placed on the trade date, and settlement of the transaction, including payment and delivery of the stock, occurs a standardized number of days after the trade date that is set by a regulator) is treated as a repurchase by the covered corporation or an acquisition by a specified affiliate of the covered corporation on the trade date.

(3) *Repurchase pursuant to certain economically similar transactions.* Stock of a covered corporation repurchased in an economically similar transaction described in paragraph (e)(4) of this section is treated as repurchased on the date the shareholders of the covered corporation exchange their stock in the covered corporation.

(4) *Constructive specified affiliate acquisition.* Stock of a covered corporation that is treated as repurchased by the covered corporation under paragraph (f)(3)(i) of this section is treated as acquired by a specified affiliate on the date on which the other corporation or partnership described in paragraph (f)(3)(i) of this section becomes a specified affiliate of the covered corporation.

(h) *Fair market value of repurchased stock*—(1) *In general.* The fair market value of stock of a covered corporation that is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation is the market price of the stock on the date the stock is repurchased or acquired (as determined under paragraph (g) of this section). That is, if the price at which the repurchased or acquired stock is purchased differs from the market price of the stock on the date the stock is repurchased or acquired, the fair market value of the stock is the market price on the date the stock is repurchased or acquired.

(2) *Stock traded on an established securities market*—(i) *In general.* If stock of a covered corporation that is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation is traded on an established securities market, the covered corporation must determine the market price of the repurchased or acquired stock by applying one of the methods provided in paragraph (h)(2)(ii) of this section. For purposes of this paragraph (h)(2), repurchased or acquired stock of a covered corporation is treated as traded on an established securities market if any stock of the same class and issue of stock is so traded, regardless of whether the shares repurchased or acquired are so traded.

(ii) *Acceptable methods.* The following are acceptable methods for determining the market price of repurchased or acquired stock of a covered corporation traded on an established securities market:

(A) The daily volume-weighted average price as determined on the date the stock is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation.

(B) The closing price on the date the stock is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation.

(C) The average of the high and low prices on the date the stock is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation.

(D) The trading price at the time the stock is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation.

(iii) *Date of repurchase not a trading day.* For purposes of each method provided in paragraph (h)(2)(ii) of this section, if the date the stock of a covered corporation is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation is not a trading day, the date on which the market price is determined is the immediately preceding trading day.

(iv) *Consistency requirement*—(A) *Solely one method permitted for determining market price of repurchased or acquired stock.* The market price of repurchased or acquired stock of a covered corporation that is traded on an established securities market must be determined by consistently applying one (but not more than one) of the methods provided in paragraph (h)(2)(ii) of this section to all stock of the covered corporation repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation throughout the covered corporation's taxable year.

(B) *Application to netting rule.* Except as provided in the second sentence of this paragraph (h)(2)(iv)(B), the method used by the covered corporation under paragraph (h)(2)(iv)(A) of this section must be consistently applied to determine the market price of all stock of the covered corporation issued or provided under the netting rule throughout the covered corporation's taxable year. The consistency rule set forth in the first sentence of this paragraph (h)(2)(iv)(B) does not apply to the determination of the fair market value of stock of a covered corporation that the covered corporation issues, or that a specified affiliate of the covered corporation provides, in connection with the performance of services. *See* § 58.4501–4(e)(5).

(v) *Stock traded on multiple exchanges*—(A) *In general.* A covered corporation the stock of which is traded on multiple established securities markets must determine the market price of the stock of the covered corporation by reference to trading on the established securities market in the country in which the covered corporation is organized, including a regional established securities market that trades in that country.

(B) *Stock traded on multiple exchanges in country where covered corporation is organized.* If a covered corporation's stock is traded on multiple established securities markets in the country in which the covered corporation is organized, the covered corporation must determine the market price of the stock by reference to trading on the established securities market in that country with the highest trading volume in that stock in the prior taxable year.

(C) *Other cases in which stock is traded on multiple exchanges.* If stock of a covered corporation is traded on multiple established securities markets and neither paragraph (h)(2)(v)(A) nor (B) of this section applies, the covered corporation must determine the fair market value of its traded stock in a manner that is reasonable under the facts and circumstances.

(3) *Stock not traded on an established securities market*—(i) *General rule.* If repurchased or acquired stock of a covered corporation is not traded on an established securities market, the market price of the stock is determined as of the date the stock is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation under the principles of § 1.409A–1(b)(5)(iv)(B)(*1*) of this chapter.

(ii) *Consistency requirement*—(A) *Solely one method permitted for determining market price of repurchased or acquired stock.* The valuation method for determining the market price of repurchased or acquired stock of a covered corporation that is not traded on an established securities market must be used for all repurchases of stock of the covered corporation or acquisitions by a specified affiliate of the covered corporation of the same class throughout the covered corporation's taxable year, unless the application of that method to a particular repurchase or acquisition would be unreasonable under the facts and circumstances as of the valuation date within the meaning of § 1.409A–1(b)(5)(iv)(B)(*1*).

(B) *Application to netting rule.* Except as provided in the second sentence of this paragraph (h)(3)(ii)(B), the method used by the covered corporation under paragraph (h)(3)(ii)(A) of this section also must be consistently applied to determine the market price of all stock of the covered corporation of the same class issued under the netting rule throughout the covered corporation's taxable year. The consistency rule set forth in the first sentence of this paragraph (h)(3)(ii)(B) does not apply to the determination of the market price of stock of the covered corporation that is issued in connection with the performance of services or if the application of that method to a particular issuance would be unreasonable under the facts and circumstances as of the valuation date.

(4) *Market price of stock denominated in non-U.S. currency.* The market price of any stock of a covered corporation that is denominated in a currency other than the U.S. dollar is converted into U.S. dollars at the spot rate (as defined in § 1.988–1(d)(1) of this chapter) on the date the stock is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation.

§ 58.4501–3 Statutory exceptions.

(a) *Scope.* This section provides rules regarding the application of each *statutory exception* (that is, each exception set forth in section 4501(e) of the Code), other than the de minimis exception described in section 4501(e)(3) and subject to § 58.4501–2(b)(2), to a repurchase of stock of a covered corporation by the covered corporation or an acquisition of stock of a covered corporation by a specified affiliate of the covered corporation (as appropriate). For rules regarding the application of the statutory exceptions in the context of section 4501(d), *see* § 58.4501–7(m).

(b) *Reduction of covered corporation's stock repurchase excise tax base.* The fair market value of stock of a covered corporation repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation in a repurchase or acquisition described in this section is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base. *See* § 58.4501–2(c)(1)(ii).

(c) *Reorganization exception.* The fair market value of stock of a covered corporation repurchased by the covered corporation in a repurchase described in any of paragraphs (c)(1) through (4) of this section is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base (that is, the reorganization exception) to the extent that the repurchase is for property permitted by section 354 or 355 to be received without the recognition of gain or loss (each, a qualifying property repurchase):

(1) A repurchase by a target corporation in an acquisitive reorganization pursuant to the plan of reorganization.

(2) A repurchase by a recapitalizing corporation in an E reorganization pursuant to the plan of reorganization.

(3) A repurchase by a transferor corporation in an F reorganization pursuant to the plan of reorganization.

(4) A repurchase by a distributing corporation in a split-off (whether or not part of a D reorganization).

(d) *Stock contributions to an employer-sponsored retirement plan*—(1) *Reductions in computing covered corporation's stock repurchase excise tax base*—(i) *General rule.* The fair market value of stock of a covered corporation that is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base if the stock that is repurchased or acquired, or an amount of stock equal to the fair market value of the stock repurchased or acquired, is contributed to an employer-sponsored retirement plan. The amount of the reduction under this paragraph (d)(1) is determined as provided in paragraph (d)(3) or (4) of this section.

(ii) *Special rule for leveraged ESOPs.* If a covered corporation or a specified affiliate of the covered corporation maintains an ESOP with an exempt loan (as defined in section 4975(d)(3)), allocations of qualifying employer securities from the ESOP suspense account to ESOP participants' accounts that are attributable to employer contributions (and not to dividends) are treated as contributions of stock under this paragraph (d) as of the date stock attributable to repayment of the exempt loan is released from the suspense account and allocated to ESOP participants' accounts.

(2) *Classes of stock contributed to an employer-sponsored retirement plan.* This paragraph (d) applies to contributions of any class of covered corporation stock to an employer-sponsored retirement plan, regardless of the class of stock that was repurchased or acquired.

(3) *Same class of stock repurchased and contributed.* If stock of a covered corporation is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation, and stock of the covered corporation of the same class is contributed to an employer-sponsored retirement plan, the amount of the reduction under paragraph (d)(1) of this section is equal to the lesser of—

(i) The aggregate fair market value of the stock of the same class that was repurchased or acquired (as determined under § 58.4501–2(h)) during the covered corporation's taxable year; or

(ii) The amount obtained by—

(A) Determining the aggregate fair market value of all stock of that class repurchased or acquired (as determined under § 58.4501–2(h)) during the covered corporation's taxable year, reduced by the fair market value of shares of that class of stock that is a reduction to the stock repurchase excise tax base for the taxable year under a statutory exception other than the exception in this paragraph (d);

(B) Dividing the amount determined under paragraph (d)(3)(ii)(A) of this section by the number of shares of that class repurchased or acquired, reduced by the number of shares of that class of

stock the fair market value of which is a reduction to the stock repurchase excise tax base for the taxable year under a statutory exception other than the exception in this paragraph (d); and

(C) Multiplying the amount determined under paragraph (d)(3)(ii)(B) of this section by the number of shares of that class contributed to an employer-sponsored retirement plan for the taxable year.

(4) *Different class of stock repurchased and contributed*—(i) *In general.* Subject to paragraph (d)(4)(ii) of this section, if stock of a covered corporation is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation, and stock of the covered corporation of a different class is contributed to an employer-sponsored retirement plan, then the amount of the reduction under paragraph (d)(1) of this section is equal to the fair market value of the contributed stock at the time the stock is contributed to the employer-sponsored retirement plan.

(ii) *Maximum reduction permitted.* The amount of the reduction under paragraph (d)(4)(i) of this section must not exceed the aggregate fair market value of stock repurchased or acquired during the covered corporation's taxable year, reduced by the fair market value of any stock that is a reduction to the stock repurchase excise tax base for the taxable year under a statutory exception other than the exception in this paragraph (d).

(5) *Timing of contributions*—(i) *In general.* The reduction in the stock repurchase excise tax base, in accordance with paragraph (d)(1) of this section (that is, the reduction in computing the stock repurchase excise tax base), for a taxable year applies to contributions of covered corporation stock to an employer-sponsored retirement plan during the covered corporation's taxable year.

(ii) *Treatment of contributions after close of taxable year.* For purposes of paragraph (d)(1) of this section, a covered corporation may treat stock contributions to an employer-sponsored retirement plan made after the close of the covered corporation's taxable year as having been contributed during that taxable year if the following two requirements are satisfied:

(A) The stock must be contributed to the employer-sponsored retirement plan by the filing deadline for the form on which the stock repurchase excise tax must be reported (applicable form) that is due for the first full quarter after the close of the covered corporation's taxable year.

(B) The stock must be treated by the employer-sponsored retirement plan in the same manner that the plan would treat a contribution received on the last day of that taxable year.

(iii) *No duplicate reductions.* Stock contributions that are treated under paragraph (d)(5)(ii) of this section as having been contributed in the taxable year to which the applicable form applies may not be treated as having been contributed for any other taxable year for purposes of the stock repurchase excise tax.

(6) *Contributions before January 1, 2023.* A covered corporation with a taxable year that both begins before January 1, 2023, and ends after December 31, 2022, may include the fair market value of all contributions of its stock to an employer-sponsored retirement plan during the entirety of that taxable year for purposes of applying this paragraph (d).

(e) *Repurchases or acquisitions by a dealer in securities in the ordinary course of business*—(1) *In general.* Subject to paragraph (e)(2) of this section, the fair market value of stock of a covered corporation repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation (as appropriate) that is a dealer in securities (within the meaning of section 475(c)(1) of the Code) is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base to the extent the stock is acquired in the ordinary course of the dealer's business of dealing in securities.

(2) *Applicability.* The reduction described in paragraph (e)(1) of this section applies solely to the extent that—

(i) The dealer accounts for the stock as securities held primarily for sale to customers in the dealer's ordinary course of business;

(ii) The dealer disposes of the stock within a period of time that is consistent with the holding of the stock for sale to customers in the dealer's ordinary course of business, taking into account the terms of the stock and the conditions and practices prevailing in the markets for similar stock during the period in which the stock is held; and

(iii) The dealer (if it is a covered corporation) does not sell or otherwise transfer the stock to a specified affiliate of the covered corporation, or the dealer (if it is a specified affiliate of the covered corporation) does not sell or otherwise transfer the stock to the covered corporation or to another specified affiliate of the covered corporation, in each case other than in a sale or transfer to a dealer that also satisfies the requirements of this paragraph (e)(2).

(f) *Repurchases by a RIC or REIT.* The fair market value of stock of a covered corporation that is a RIC or a REIT that is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base.

(g) *Repurchase treated as a dividend*—(1) *Reduction of covered corporation's stock repurchase excise tax base.* Except as provided in paragraph (g)(2)(ii) of this section, the fair market value of stock of a covered corporation repurchased by the covered corporation (excluding stock treated as repurchased under § 58.4501–2(f)(1) and (3)) is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base to the extent the repurchase is treated as a distribution of a dividend under section 301(c)(1) or 356(a)(2).

(2) *Rebuttable presumption of no dividend equivalence*—(i) *Presumption.* A repurchase to which section 302 or 356(a) applies is presumed to be subject to section 302(a) or 356(a)(1), respectively (and, therefore, is presumed ineligible for the exception in paragraph (g)(1) of this section).

(ii) *Rebuttal of presumption.* A covered corporation may rebut the presumption described in paragraph (g)(2)(i) of this section with regard to a specific shareholder solely by establishing with sufficient evidence that the shareholder treats the repurchase as a dividend on the shareholder's Federal income tax return.

(iii) *Sufficient evidence requirement.* To provide sufficient evidence under paragraph (g)(2)(ii) of this section to establish that the shareholder treats the repurchase as a dividend on the shareholder's Federal income tax return, the covered corporation must—

(A) Obtain certification from the shareholder, in accordance with paragraph (g)(3) of this section, that the repurchase constitutes a redemption treated as a distribution to which section 301 applies by reason of section 302(d), or that the repurchase has the effect of the distribution of a dividend under section 356(a)(2), including evidence that applicable withholding occurred if required;

(B) Treat the repurchase consistent with the shareholder certification required under paragraph (g)(2)(iii)(A) of this section;

(C) Have no knowledge of facts that would indicate that the shareholder certification required under paragraph

(g)(2)(iii)(A) of this section is incorrect; and

(D) Demonstrate sufficient earnings and profits to treat as a dividend either the redemption under section 302 or the receipt of money or other property under section 356.

(3) *Content of shareholder certification.* The shareholder certification required under paragraph (g)(2)(iii)(A) of this section must include the following information:

(i) The name of the shareholder.

(ii) The name of the covered corporation.

(iii) The total number of shares of the covered corporation outstanding immediately before and immediately after the repurchase.

(iv) A certification from the shareholder that either—

(A) The repurchase is a payment in exchange for stock because the shareholder's proportionate interest in the corporation has been reduced but not completely terminated;

(B) The repurchase is a payment in exchange for stock because the shareholder's interest in the corporation is completely terminated; or

(C) The repurchase is a dividend.

(v) With respect to the certification described in paragraph (g)(3)(iv) of this section—

(A) The number of shares actually and constructively owned by the shareholder before and after the repurchase; and

(B) The shareholder's percentage ownership before and after the repurchase.

(vi) With respect to the certification described in paragraph (g)(3)(iv)(C) of this section, if the shareholder is not a United States person (within the meaning of section 7701(a)(30)) and the shares are held through a broker (within the meaning of section 6045(c) of the Code), the certification also must include a statement that a copy of the certification has been provided to the shareholder's broker.

(vii) Any other information required by the IRS in forms or instructions or in publications or guidance published in the Internal Revenue Bulletin (*see* §§ 601.601(d)(2) and 601.602 of this chapter).

(viii) A penalties of perjury statement.

(ix) The signature of the shareholder and date of signature.

(4) *Agreement to shareholder certification.* After receiving the shareholder certification required under paragraph (g)(2)(iii)(A) of this section, the covered corporation must include on the shareholder certification a statement signed by the covered corporation under penalties of perjury that the covered corporation—

(i) Agrees to treat the repurchase consistent with the shareholder certification required under paragraph (g)(2)(iii)(A) of this section; and

(ii) Has no knowledge of facts that would indicate that the shareholder certification required under paragraph (g)(2)(iii)(A) of this section is incorrect.

(5) *Documentation of sufficient evidence*—(i) *Retention and availability of evidence.* A covered corporation must retain the evidence described in paragraph (g)(2)(iii) of this section and make that evidence available for inspection to the IRS if any of the evidence becomes material in the administration of any internal revenue law.

(ii) *Retention of supporting records.* The covered corporation must retain records of all information necessary to document and substantiate all content of the shareholder certification described in paragraph (g)(2)(iii)(A) of this section.

§ 58.4501–4 Application of netting rule.

(a) *Scope.* This section provides rules regarding the application of section 4501(c)(3) of the Code. Paragraph (b) of this section provides general rules regarding the adjustment to a covered corporation's stock repurchase excise tax base with respect to stock that is issued by the covered corporation or provided by a specified affiliate of the covered corporation (netting rule). Paragraph (c) of this section provides special rules for stock issued or provided in connection with the performance of services. Paragraph (d) of this section provides rules for determining the date on which stock is issued or provided. Paragraph (e) of this section provides rules for determining the fair market value of stock that is issued or provided. Paragraph (f) of this section sets forth the sole circumstances under which an issuance or provision of stock is disregarded for purposes of the netting rule. For rules regarding the application of the netting rule in the context of section 4501(d), *see* § 58.4501–7(n).

(b) *Issuances and provisions of stock that are a reduction in computing the stock repurchase excise tax base*—(1) *General rule.* Under the *netting rule* provided by this paragraph (b)(1), the aggregate fair market value of stock of a covered corporation is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base for a taxable year if the stock is issued by the covered corporation or provided by a specified affiliate of the covered corporation in the following circumstances:

(i) Issued by the covered corporation during the covered corporation's taxable year in connection with the performance of services for the covered corporation by an employee or other service provider of the covered corporation.

(ii) Provided by a specified affiliate of the covered corporation in connection with the performance of services for the specified affiliate by an employee of the specified affiliate during the covered corporation's taxable year.

(iii) Issued by the covered corporation during the covered corporation's taxable year not in connection with the performance of services.

(2) *Stock issued or provided outside period of covered corporation status.* Any stock of a covered corporation issued by the covered corporation or provided by a specified affiliate of the covered corporation before the initiation date or after the cessation date is not taken into account under paragraph (b)(1) of this section. *See* § 58.4501–2(d).

(3) *Issuances or provisions before January 1, 2023.* Except as provided in paragraph (b)(2) of this section, a covered corporation with a taxable year that begins before January 1, 2023, and ends after December 31, 2022, must include the fair market value of all issuances or provisions of its stock during the entirety of that taxable year for purposes of applying paragraph (b)(1) of this section to that taxable year.

(4) *F reorganizations.* For purposes of this section, the transferor corporation and the resulting corporation (as defined in § 1.368–2(m)(1) of this chapter) in an F reorganization are treated as the same corporation.

(c) *Stock issued or provided in connection with the performance of services*—(1) *In general.* For purposes of this section, stock of a covered corporation is transferred by the covered corporation or a specified affiliate of the covered corporation in connection with the performance of services only if the transfer is described in section 83, including pursuant to a nonqualified stock option described in § 1.83–7 of this chapter, or is pursuant to a stock option described in section 421 of the Code. A specified affiliate of the covered corporation is not a service provider for purposes of this section.

(2) *Sale of shares to cover exercise price and withholding*—(i) *Payment or advance by third party equal to exercise price.* If a third party pays the exercise price of a stock option on behalf of a service provider or advances to a service provider an amount equal to the exercise price of a stock option that the service provider uses to exercise the option, then any stock transferred by the

covered corporation to the service provider, by a specified affiliate to the specified affiliate's employee, or by the covered corporation or specified affiliate to the third party upon exercise of the option in connection with exercising the option is treated as issued or provided in connection with the performance of the services.

(ii) *Advance by third party equal to withholding obligation.* If a third party advances an amount equal to the withholding obligation of a service provider, then any stock transferred by the covered corporation to the service provider, by a specified affiliate to the specified affiliate's employee, or by the covered corporation or specified affiliate to the third party in connection with this arrangement is treated as issued or provided in connection with the performance of services.

(d) *Date of issuance*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, stock of a covered corporation is treated as issued by the covered corporation or provided by a specified affiliate of the covered corporation on the date on which ownership of the stock transfers to the recipient for Federal income tax purposes.

(2) *Stock issued or provided in connection with the performance of services*—(i) *In general.* Stock of a covered corporation is issued by the covered corporation or provided by a specified affiliate of the covered corporation in connection with the performance of services as of the date the recipient of the stock is treated as the beneficial owner of the stock for Federal income tax purposes. In general, a recipient is treated as the beneficial owner of the stock when the stock is both transferred by the covered corporation (or a specified affiliate of the covered corporation) and substantially vested within the meaning of § 1.83–3(b) of this chapter. Thus, stock transferred pursuant to a vested stock award or restricted stock unit is issued or provided when the covered corporation or a specified affiliate of the covered corporation initiates payment of the stock. Stock transferred that is not substantially vested within the meaning of § 1.83–3(b) of this chapter is not issued or provided until it vests, except as provided in paragraph (d)(2)(iii) of this section.

(ii) *Stock options and stock appreciation rights.* Stock of a covered corporation transferred by the covered corporation or a specified affiliate of the covered corporation pursuant to an option described in § 1.83–7 of this chapter or section 421 or a stock appreciation right is issued by the covered corporation or provided by the specified affiliate of the covered corporation (as applicable) as of the date the option or stock appreciation right is exercised.

(iii) *Stock on which a section 83(b) election is made.* Stock of a covered corporation transferred by the covered corporation or a specified affiliate of the covered corporation when it is not substantially vested within the meaning of § 1.83–3(b) of this chapter, but as to which a valid election under section 83(b) is made, is treated as issued by the covered corporation or provided by the specified affiliate of the covered corporation (as applicable) as of the transfer date.

(e) *Fair market value of issued or provided stock*—(1) *In general.* Except as provided in paragraph (e)(5) of this section, the fair market value of stock of a covered corporation issued by the covered corporation or provided by a specified affiliate of the covered corporation is the market price of the stock on the date the stock is issued or provided.

(2) *Stock traded on an established securities market*—(i) *In general.* If stock of a covered corporation that is issued by the covered corporation is traded on an established securities market, the covered corporation must determine the market price of the stock by applying one of the methods provided in paragraph (e)(2)(ii) of this section.

(ii) *Acceptable methods.* The following are acceptable methods for determining the market price of stock of a covered corporation traded on an established securities market:

(A) The daily volume-weighted average price as determined on the date the stock is issued by the covered corporation.

(B) The closing price on the date the stock is issued by the covered corporation.

(C) The average of the high and low prices on the date the stock is issued by the covered corporation.

(D) The trading price at the time the stock is issued by the covered corporation.

(iii) *Date of issuance not a trading day.* For purposes of each method provided in paragraph (e)(2)(ii) of this section, if the date the stock of a covered corporation is issued by the covered corporation is not a trading day, the date on which the market price is determined is the immediately preceding trading day.

(iv) *Consistency requirement*—(A) *Solely one method permitted for determining market price of issued stock.* The market price of stock of a covered corporation that is traded on an established securities market must be determined by consistently applying solely one of the methods provided in paragraph (e)(2)(ii) of this section to all stock of the covered corporation issued by the covered corporation throughout the covered corporation's taxable year.

(B) *Application to repurchased stock.* The method used by the covered corporation under paragraph (e)(2)(ii)(A) of this section must be consistently applied to determine the market price of all stock of the covered corporation repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation throughout the covered corporation's taxable year. *See* § 58.4501–2(h)(2)(iv).

(v) *Stock traded on multiple exchanges. See* § 58.4501–2(h)(2)(v) for rules regarding the valuation of stock of a covered corporation traded on multiple established securities markets.

(3) *Stock not traded on an established securities market*—(i) *General rule.* If stock of a covered corporation is not traded on an established securities market, the market price of the stock is determined as of the date the stock is issued by a covered corporation under the principles of § 1.409A–1(b)(5)(iv)(B)(*1*) of this chapter.

(ii) *Consistency requirement.* In determining the market price of stock of a covered corporation that is not traded on an established securities market, the same valuation method must be used for all issuances of stock of the covered corporation belonging to the same class throughout the covered corporation's taxable year, unless the application of that method to a particular issuance would be unreasonable under the facts and circumstances as of the valuation date. That same method also must be consistently applied to determine the market price of all stock of the covered corporation of the same class repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation throughout the covered corporation's taxable year, unless the application of that method to a particular issuance would be unreasonable under the facts and circumstances as of the valuation date. *See* § 58.4501–2(h)(3)(ii).

(4) *Market price of stock denominated in non-U.S. currency.* The market price of any stock of a covered corporation that is denominated in a currency other than the U.S. dollar is converted into U.S. dollars at the spot rate (as defined in § 1.988–1(d)(1) of this chapter) on the date the stock is issued by the covered corporation or provided by a specified affiliate of the covered corporation (as applicable).

(5) *Stock issued or provided in connection with the performance of services.* The fair market value of stock of a covered corporation issued by the covered corporation or provided by a specified affiliate of the covered corporation (as applicable) in connection with the performance of services is the fair market value of the stock, as determined under section 83, as of the date the stock is issued by the covered corporation or provided by the specified affiliate of the covered corporation (as applicable). For purposes of this section, the fair market value of the stock is determined under the rules provided in section 83 regardless of whether an amount is includible in the service provider's income under section 83 or otherwise. For example, the fair market value of stock issued by a covered corporation pursuant to a stock option described in section 421 and stock issued by a covered corporation to a nonresident alien for services performed outside of the United States is determined using the rules provided in section 83.

(f) *Issuances that are disregarded for purposes of applying the netting rule.* This paragraph (f) lists the sole circumstances in which an issuance of stock of a covered corporation is disregarded for purposes of the netting rule.

(1) *Distributions by a covered corporation of its own stock.* Stock of a covered corporation distributed by the covered corporation to its shareholders with respect to the covered corporation's stock is disregarded for purposes of the netting rule.

(2) *Issuances to a specified affiliate*—(i) *In general.* Subject to paragraphs (f)(2)(ii) through (iv) of this section, stock of a covered corporation issued by the covered corporation to a specified affiliate of the covered corporation, or issued by the covered corporation in connection with the performance of services by an employee or other service provider for a specified affiliate of the covered corporation, is disregarded for purposes of the netting rule.

(ii) *Subsequent transfer by specified affiliate.* Stock of a covered corporation issued by the covered corporation to a specified affiliate of the covered corporation that is subsequently transferred by the specified affiliate of the covered corporation to a person that is not a specified affiliate of the covered corporation is regarded for purposes of the netting rule, and is treated as issued by the covered corporation on the date of the subsequent transfer, only if—

(A) The subsequent transfer by the specified affiliate occurs within the same taxable year that the specified affiliate receives the stock from the covered corporation (*applicable year*);

(B) The covered corporation does not otherwise reduce its stock repurchase excise tax base for the applicable year with respect to the stock under this section; and

(C) The subsequent transfer by the specified affiliate is not in connection with the performance of services provided to the specified affiliate.

(iii) *Specific identification.* For purposes of paragraph (f)(2)(ii) of this section, unless specifically identified, the shares of stock of the covered corporation treated as subsequently transferred by the specified affiliate are the earliest shares issued by the covered corporation to the specified affiliate.

(iv) *Subsequent transfers in connection with the performance of services for a specified affiliate.* Stock issued by a covered corporation in connection with the performance of services for a specified affiliate is not treated as issued by the covered corporation. However, a transfer of stock of a covered corporation described in § 1.83–6(d) of this chapter (in addition to an actual provision of stock by a specified affiliate described in paragraph (b)(1)(ii) of this section) by a specified affiliate of the covered corporation to an employee of the specified affiliate is treated as a provision of stock described in paragraph (b)(1)(ii) of this section.

(3) *No double benefit for issuances that are part of a transaction to which the reorganization exception applies.* Stock of a covered corporation issued by the covered corporation as part of a transaction qualifying as a reorganization under section 368(a) or a distribution under section 355 is disregarded for purposes of the netting rule if—

(i) The stock constitutes property permitted to be received under section 354 or 355 without the recognition of gain;

(ii) The stock is used by another covered corporation (second covered corporation) to repurchase stock of the second covered corporation in a transaction that is a repurchase under § 58.4501–2(e)(4)(i), (ii), (iii), or (iv); and

(iii) The repurchase described in paragraph (f)(3)(ii) of this section is not included in the second covered corporation's stock repurchase excise tax base because that repurchase is a qualifying property repurchase.

(4) *Deemed issuances under section 304(a)(1).* Any stock treated as issued by the acquiring corporation by reason of the application of section 304(a)(1) to a transaction (as more fully described in § 58.4501–2(e)(3)(i)) is disregarded for purposes of the netting rule.

(5) *Deemed issuance of a fractional share.* Any fractional share of a covered corporation's stock deemed to be issued for Federal income tax purposes (in a payment described in § 58.4501–2(e)(3)(ii)) is disregarded for purposes of the netting rule.

(6) *Issuance by a covered corporation that is a dealer in securities.* Any stock of a covered corporation issued by the covered corporation that is a dealer in securities is disregarded for purposes of the netting rule to the extent the stock is issued, or otherwise is used to satisfy obligations to customers arising, in the ordinary course of the dealer's business of dealing in securities.

(7) *Issuance by the target corporation in a reverse triangular merger.* Any target corporation stock that is issued by the target corporation to the merged corporation (within the meaning of section 368(a)(2)(E)) in exchange for consideration that includes the stock of the controlling corporation (within the meaning of section 368(a)(2)(E)) in a transaction qualifying as a reverse triangular merger is disregarded for purposes of the netting rule.

(8) *Issuance as part of a section 1036(a) exchange.* Any stock of a covered corporation issued by the covered corporation in exchange for stock of the covered corporation in a transaction that qualifies under section 1036(a) of the Code is disregarded for purposes of the netting rule.

(9) *Issuance as part of a distribution under section 355.* Any stock issued by a controlled corporation in a distribution qualifying under section 355 (or so much of section 356 as relates to section 355) that is not a split-off is disregarded for purposes of the netting rule.

(10) *Stock contributions to an employer-sponsored retirement plan.* Any stock of a covered corporation contributed to an employer-sponsored retirement plan, any stock of a covered corporation treated as contributed to an employer-sponsored retirement plan under § 58.4501–3(d)(1)(ii) and (d)(5)(ii), and any stock of a covered corporation sold to a leveraged or non-leveraged ESOP, is disregarded for purposes of the netting rule.

(11) *Net exercises and share withholding*—(i) *In general.* Stock of a covered corporation withheld by the covered corporation or a specified affiliate of the covered corporation to satisfy the exercise price of a stock option issued in connection with the performance of services, or to pay any withholding obligation, is disregarded for purposes of the netting rule. For

example, stock of a covered corporation withheld by a covered corporation or a specified affiliate of the covered corporation to pay the exercise price of a stock option, to satisfy an employer's income tax withholding obligation under section 3402 of the Code, to satisfy an employer's withholding obligation under section 3102 of the Code, or to satisfy an employer's withholding obligation for State, local, or foreign taxes, is disregarded for purposes of the netting rule.

(ii) *Net share settlement not in connection with the performance of services.* Settlement in net shares of an option or other derivative financial instrument that is not issued in connection with the performance of services is treated as an issuance of the net shares delivered.

(12) *Settlement other than in stock.* Settlement of an option contract with respect to stock of a covered corporation using any consideration other than stock of the covered corporation (including cash) is disregarded for purposes of the netting rule.

(13) *Instrument not in the legal form of stock*—(i) *Generally disregarded.* Except as provided in paragraph (f)(13)(ii) of this section, the issuance by a covered corporation or provision by a specified affiliate of the corporation of an instrument that is not in the legal form of stock of the covered corporation but is treated as stock for Federal income tax purposes (*non-stock instrument*) is disregarded for purposes of the netting rule.

(ii) *Certain instruments treated as issued*—(A) *In general.* Subject to paragraphs (f)(13)(ii)(B), (C), and (D) of this section, if a non-stock instrument is repurchased by a covered corporation or acquired by a specified affiliate of the covered corporation, the issuance or provision of the instrument is regarded for purposes of the netting rule at the time of such repurchase or acquisition. For purposes of the stock repurchase excise tax regulations, the delivery of stock pursuant to the terms of a non-stock instrument is treated as a repurchase of the non-stock instrument in exchange for an issuance or provision of the stock that is delivered.

(B) *Issuance or provision before the initiation date or after the cessation date.* Any non-stock instrument issued by the covered corporation or provided by a specified affiliate of the covered corporation before the initiation date or after the cessation date is not regarded for purposes of the netting rule.

(C) *Identification of an instrument not in the legal form of stock.* The covered corporation must identify the repurchase or acquisition of a non-stock instrument as the repurchase or acquisition of a non-stock instrument on the return on which the stock repurchase excise tax must be reported for the covered corporation's taxable year in which the repurchase or acquisition occurs (*repurchase year*) in order for the issuance or provision to be regarded under paragraph (f)(13)(ii)(A) of this section.

(D) *Consistency requirement.* In the repurchase year of a non-stock instrument (*tested non-stock instrument*), the issuance or provision of the non-stock instrument is not regarded under paragraph (f)(13)(ii)(A) of this section unless the covered corporation reports or has reported the repurchase or acquisition of all other comparable non-stock instruments repurchased or acquired within the five taxable years ending on the last day of the repurchase year in a consistent manner. A comparable non-stock instrument is a non-stock instrument that has substantially similar economic terms as the tested non-stock instrument, regardless of whether the comparable non-stock instrument and the tested non-stock instrument have the same legal form. A comparable non-stock instrument is reported in a consistent manner if it is or was timely reported on the return on which the stock repurchase excise tax must be reported that is or was due for the first full quarter after the close of the repurchase year for such comparable non-stock instrument. Notwithstanding the first sentence of this paragraph (f)(13)(ii)(D), the issuance or provision of the tested non-stock instrument will be regarded if the covered corporation demonstrates to the satisfaction of the IRS that the covered corporation's failure to timely report the repurchase or acquisition of the comparable non-stock instruments was due to reasonable cause (within the meaning of § 1.6664–4 of this chapter) and not willful neglect. In determining whether this failure to report was due to reasonable cause and not willful neglect, the IRS will consider all the facts and circumstances, including the steps the covered corporation took to comply with its Federal tax reporting and payment obligations.

(E) *Fair market value of the instrument.* The amount of the reduction for purposes of computing the covered corporation's stock repurchase excise tax base for a taxable year under this section for the issuance or provision of a non-stock instrument is equal to the lesser of the fair market value of the instrument when the instrument was issued or provided within the meaning of paragraph (e) of this section or the fair market value of the instrument at the time of the repurchase by the covered corporation or acquisition by the specified affiliate of the covered corporation.

§ 58.4501–5 Examples.

(a) *Scope.* This examples in this section illustrate the application of section 4501 of the Code and the stock repurchase excise tax regulations other than the provisions of section 4501(d) and § 58.4501–7. *See* § 58.4501–7(p) and (q) for examples that illustrate the application of the rules in § 58.4501–7 related to section 4501(d)(1) and (2), respectively.

(b) *In general.* For purposes of the examples in this section, unless otherwise stated: each of Corporation X and unrelated Target is a covered corporation that is a calendar-year taxpayer; the only outstanding stock of each of Corporation X and Target is a single class of common stock that is traded on an established securities market; any shareholder whose stock is redeemed in a section 317(b) redemption qualifies for sale or exchange treatment under section 302(a); the de minimis exception does not apply; the receipt of money or other property by any shareholder whose stock is repurchased in an acquisitive reorganization or an E reorganization is not treated as having the effect of a distribution of a dividend under section 356(a)(2); the covered corporation determines the fair market value of its stock repurchased or issued based on the trading price of the stock at the time it is repurchased or issued; and any instrument that is not in the legal form of stock is not treated as stock for Federal income tax purposes.

(1) *Example 1: Redemption of preferred stock*—(i) *Facts.* Corporation X has outstanding common stock that is traded on an established securities market. Corporation X also has outstanding mandatorily redeemable preferred stock that is stock for Federal tax purposes but that is neither additional tier 1 capital nor traded on an established securities market. On January 1, 2024, Corporation X redeems the preferred stock pursuant to its terms.

(ii) *Analysis.* The redemption by Corporation X of its mandatorily redeemable preferred stock is a repurchase because Corporation X redeemed an instrument that is stock for Federal tax purposes (that is, mandatorily redeemable preferred stock issued by Corporation X) and the redemption is a section 317(b) redemption. *See* §§ 58.4501–1(b)(29) and 58.4501–2(e)(2)(i).

(2) *Example 2: Valuation of repurchase*—(i) *Facts.* On April 15, 2024, when the stock of Corporation X is trading at $0.70x per share, Corporation X purchases 50 shares of its stock for $35x from one of its shareholders on an established securities market. The shareholder is required to deliver the stock

to Corporation X within the standard settlement cycle for the stock (a regular-way sale), which is one business day after execution of the sale (that is, the trade date of April 15, 2024). On April 17, 2024, the 50 shares are delivered to Corporation X.

(ii) *Analysis.* Corporation X's purchase of 50 shares of Corporation X stock is a repurchase because the transaction is a section 317(b) redemption. *See* § 58.4501–2(e)(2)(i). For purposes of computing Corporation X's stock repurchase excise tax base, the trade date of April 15, 2024, is the date of repurchase. *See* § 58.4501–2(g)(1). The fair market value of the 50 shares of stock repurchased on April 15, 2024, is the aggregate market price of those shares on the date of repurchase, or $35x ($0.70x per share x 50 shares = $35x). *See* § 58.4501–2(h)(1). Accordingly, the repurchase by Corporation X increases its stock repurchase excise tax base for the 2024 taxable year by $35x.

(iii) *Application of netting rule.* The facts are the same as in paragraph (b)(2)(i) of this section (*Example 2*), except that, on August 1, 2024, Corporation X issues 20 shares of its stock to an unrelated party, at which time ownership of the stock transfers to the unrelated party for Federal income tax purposes. On that date, the stock of Corporation X is trading at $0.50x per share. For purposes of computing Corporation X's stock repurchase excise tax base, Corporation X is treated as issuing the 20 shares of its stock on August 1, 2024 (that is, the date on which ownership of the stock transfers to the recipient for Federal income tax purposes). *See* § 58.4501–4(d)(1). The fair market value of that issued stock is its aggregate market price on the date of issuance by Corporation X, or $10x ($0.50x per share x 20 shares = $10x). *See* § 58.4501–4(e)(1). Accordingly, the net increase in Corporation X's stock repurchase excise tax base for its 2024 taxable year is $25x ($35x repurchase − $10x issuance = $25x). *See* § 58.4501–2(c)(1).

(3) *Example 3: Acquisition partially funded by the target corporation*—(i) *Facts.* On May 30, 2024, Corporation X acquires all of Target's outstanding stock (Target Stock Acquisition). To effectuate the Target Stock Acquisition, Corporation X causes the following transactions steps to occur. First, Corporation X contributes $40x to a newly formed corporation (Merger Sub). Second, Merger Sub merges into Target, with Target surviving the merger (Subsidiary Merger). At the time of the Subsidiary Merger, the stock of Target has an aggregate fair market value of $100x. In the Subsidiary Merger, Target's shareholders exchange all their Target stock for $100x of cash, of which $60x is funded by Target and $40x is funded by Corporation X. For Federal income tax purposes, the transitory existence of Merger Sub is disregarded, and Target is treated as if Target redeemed 60 percent of its outstanding stock for $60x as part of the Subsidiary Merger. (This treatment results from the fact that Target funded $60x of the consideration received by Target's shareholders in exchange for their Target stock.) All of Target's stock ceases to trade on an established securities market upon completion of the Target Stock Acquisition.

(ii) *Analysis.* Target ceases to be a covered corporation at the end of the day on May 30, 2024 (that is, the cessation date of Target). *See* § 58.4501–2(d)(2). Target's redemption of 60 percent of its outstanding stock is a redemption within the meaning of section 317(b) with regard to the stock of a covered corporation. *See* § 58.4501–1(b)(24). In addition, Target's redemption is not included in the exclusive list of transactions under § 58.4501–2(e)(3) that are treated as a section 317(b) redemption but are not a repurchase. Accordingly, the redemption is a repurchase. *See* § 58.4501–2(e)(2). Therefore, as a result of the Target Stock Acquisition, Target's stock repurchase excise tax base for its 2024 taxable year is increased by $60x. *See* § 58.4501–2(c)(1).

(4) *Example 4: Leveraged buyout*—(i) *Facts.* The facts are the same as in paragraph (b)(3)(i) of this section (*Example 3*), except that $60x of the consideration received by Target's shareholders in exchange for their Target stock is funded by a $60x loan to Merger Sub from an unrelated lender. In the Subsidiary Merger, Target assumes Merger Sub's obligation on the $60x loan. As a result of the disregarded transitory existence of Merger Sub, the Target Stock Acquisition is treated for Federal income tax purposes as though Target directly borrowed $60x from the unrelated lender and then used the loan proceeds to redeem $60x of its stock from the Target shareholders.

(ii) *Analysis.* The analysis is the same as in paragraph (b)(3)(ii) of this section (*Example 3*).

(5) *Example 5: Pro rata stock split*—(i) *Facts.* On October 1, 2024, Corporation X distributes three shares of Corporation X stock with respect to each existing share of its outstanding stock (Corporation X Stock Split).

(ii) *Analysis.* The stock distributed by Corporation X to its shareholders through the Corporation X Stock Split is disregarded for purposes of the netting rule because Corporation X distributed the stock to its shareholders with respect to its outstanding stock. *See* § 58.4501–4(f)(1). Accordingly, the Corporation X Stock Split is not taken into account in computing Corporation X's stock repurchase excise tax base for its 2024 taxable year. *See* § 58.4501–2(c)(1) (regarding the computation of the stock repurchase excise tax base).

(6) *Example 6: Acquisition of a target corporation in an acquisitive reorganization*—(i) *Facts.* On October 1, 2024, Target merges into Corporation X in a transaction that qualifies as an A reorganization (Target Merger). On the date of the Target Merger, the fair market value of Target's outstanding stock is $100x. In the Target Merger, Target's shareholders exchange $60x of their Target stock for Corporation X stock and $40x of their Target stock for $40x of cash.

(ii) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Target shareholders of their Target stock for the consideration received in the Target Merger is a repurchase by Target because the exchange is an economically similar transaction. *See* § 58.4501–2(e)(2)(ii) and (e)(4)(i). This repurchase occurs on October 1, 2024 (that is, the date on which the Target shareholders exchange their Target shares as part of the Target Merger). *See* § 58.4501–2(g)(2). The amount of this repurchase by Target is $100x, which equals the aggregate fair market value of the Target stock on the date the stock is exchanged by the Target shareholders as part of the Target Merger (that is, October 1, 2024). *See* § 58.4501–2(h)(1).

(iii) *Analysis regarding impact of Target Merger on Target's stock repurchase excise tax base.* Target's stock repurchase excise tax base for its 2024 taxable year initially is increased by $100x on account of the Target Merger. *See* § 58.4501–2(c)(1)(i). Under the reorganization exception, the fair market value of the Target stock exchanged by the Target shareholders for Corporation X stock in the Target Merger (that is, $60x) is a reduction in Target's stock repurchase excise tax base. *See* §§ 58.4501–2(c)(1)(ii) and 58.4501–3(c)(1) (regarding acquisitive reorganizations). However, the fair market value of the Target stock exchanged by the Target shareholders for $40x of cash in the Target Merger does not qualify for the reorganization exception. *See* § 58.4501–3(c). Therefore, Target's stock repurchase excise tax base for its 2024 taxable year is increased by $40x ($100x repurchase − $60x exception = $40x) as a result of the Target Merger.

(iv) *Analysis regarding impact of Target Merger on Corporation X's stock repurchase excise tax base.* Corporation X's transfer of Corporation X stock to Target in the Target Merger is disregarded for purposes of the netting rule because Corporation X's issuance of that stock is part of a transaction to which the reorganization exception applies. *See* § 58.4501–4(f)(3) (disregarding such types of issuances to ensure no double benefit). Specifically, Corporation X's transfer of Corporation X stock to Target is disregarded for purposes of the netting rule because the Corporation X stock constitutes property permitted to be received under section 354 without the recognition of gain, the Corporation X stock is used by a covered corporation (that is, Target) to repurchase its stock in a transaction that is a repurchase under § 58.4501–2(e)(4)(i), and the repurchase by Target is not included in Target's stock repurchase excise tax base because it is a qualifying property repurchase. *See id.* Therefore, Corporation X does not take into account any of the $60x of its stock transferred to Target in the Target Merger in computing Corporation X's stock repurchase excise tax base for its 2024 taxable year under § 58.4501–4(b)(1).

(7) *Example 7: Cash paid in lieu of fractional shares*—(i) *Facts.* The facts are the same as in paragraph (b)(6)(i) of this section (*Example 6*). Additionally, the exchange ratio in the Target Merger is 1.25 shares of Corporation X stock for each share of Target stock. As part of the Target Merger, Shareholder A (who owns two shares of Target stock) receives two shares of Corporation X stock as well as cash in lieu of a 0.5 fractional share in Corporation X. The payment by Corporation X to Shareholder A of cash in lieu of a fractional share of Corporation X stock was not separately bargained-for consideration (that is, the cash paid by Corporation X in lieu of the fractional shares represented a mere

rounding off of the two Corporation X shares issued to Shareholder A in the exchange). In addition, the payment by Corporation X to Shareholder A of cash in lieu of a fractional share of Corporation X stock was carried out solely for administrative convenience (and therefore, solely for non-tax reasons) and was for an amount of cash that did not exceed the value of one full share of Corporation X stock.

(ii) *Analysis.* The payment by Corporation X of cash to Shareholder A in lieu of a fractional share of Corporation X stock is treated for Federal income tax purposes as though the 0.5 fractional share were distributed by Corporation X to Shareholder A as part of the Target Merger and then redeemed by Corporation X for cash. This deemed redemption is not a repurchase because the payment of cash in lieu of a fractional share satisfies the requirements of § 58.4501–2(e)(3)(ii). In addition, Corporation X's deemed issuance of the fractional share to Shareholder A is disregarded for purposes of the netting rule. *See* § 58.4501–4(f)(5).

(8) *Example 8: Two-step asset acquisition*—(i) *Facts.* Corporation X acquires the assets of Target through the following transaction steps pursuant to an integrated plan to effect the acquisition. First, on September 30, 2024, Corporation X contributes $60x of Corporation X stock and $40x of cash to a newly formed subsidiary (Merger Sub). Second, on October 1, 2024, Merger Sub merges into Target in a statutory merger, with Target surviving (Subsidiary Merger). Third, on October 15, 2024, Target merges into Corporation X in a statutory merger (Upstream Merger). On the date of the Subsidiary Merger, the fair market value of Target's outstanding stock is $100x. In the Subsidiary Merger, $60x of Target stock is exchanged for Corporation X stock, and $40x of Target stock is exchanged for $40x of cash. For Federal income tax purposes, the Subsidiary Merger and the Upstream Merger are integrated into a single statutory merger of Target into Corporation X that qualifies as an A reorganization.

(ii) *Analysis.* The analysis is the same as in paragraph (b)(6) of this section (*Example 6*).

(9) *Example 9: E reorganization*—(i) *Facts.* On November 1, 2024, Corporation X issues new stock, with an aggregate fair market value of $100x (New Common Stock), to its shareholders in exchange for their outstanding stock in Corporation X (Old Common Stock). The exchange (Recapitalization) qualifies as an E reorganization. At the time of the Recapitalization, the fair market value of Corporation X's Old Common Stock is $100x.

(ii) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Corporation X shareholders of their Old Common Stock for New Common Stock in the Recapitalization pursuant to the plan of reorganization is a repurchase by Corporation X because that exchange is an economically similar transaction. *See* § 58.4501–2(e)(2)(ii) and (e)(4)(ii). This repurchase occurs on November 1, 2024 (that is, the date on which the Target shareholders exchange their old Common Stock pursuant to the plan of reorganization). *See* § 58.4501–2(g)(2). The amount of this repurchase by Corporation X is $100x, which equals the aggregate fair market value of the Old Common Stock on the date that stock is exchanged by the Corporation X shareholders pursuant to the plan of reorganization (that is, November 1, 2024). *See* § 58.4501–2(h)(1).

(iii) *Analysis regarding impact of repurchase of Old Common Stock on Corporation X's stock repurchase excise tax base.* Corporation X's stock repurchase excise tax base for its 2024 taxable year initially is increased by $100x on account of the Recapitalization. *See* § 58.4501–2(c)(1)(i). Under the reorganization exception, the fair market value of the Old Common Stock exchanged by the Corporation X shareholders for New Common Stock in the Recapitalization (that is, $100x) is a qualifying property repurchase that reduces the amount of Corporation X's stock repurchase excise tax base. *See* §§ 58.4501–2(c)(1)(ii) and § 58.4501–3(c)(2). Consequently, because all the Old Common Stock was exchanged by the Corporation X shareholders for New Common Stock, the Recapitalization does not increase Corporation X's stock repurchase excise tax base for its 2024 taxable year ($100x repurchase − $100x exception = $0).

(iv) *Analysis regarding impact of issuance of New Common Stock on Corporation X's stock repurchase excise tax base.* Corporation X's issuance of the New Common Stock is disregarded for purposes of the netting rule because Corporation X's issuance of that stock is part of a transaction to which the reorganization exception applies. *See* § 58.4501–4(f)(3) (disregarding such types of issuances to ensure no double benefit). Specifically, Corporation X's issuance of its New Common Stock to Corporation X's shareholders is disregarded for purposes of the netting rule because the New Common Stock constitutes property permitted to be received under section 354 without the recognition of gain, the New Common Stock is used by a covered corporation (that is, Corporation X) to repurchase its stock in a transaction that is a repurchase under § 58.4501–2(e)(4)(ii), and the repurchase by Corporation X is not included in Corporation X's stock repurchase excise tax base for its 2024 taxable year because it is a qualifying property repurchase. *See id.* Therefore, Corporation X does not take into account any of the $100x of New Common Stock issued to its shareholders in computing its stock repurchase excise tax base for its 2024 taxable year under § 58.4501–4(b)(1).

(10) *Example 10: F reorganization*—(i) *Facts.* Corporation X is a State A corporation. In order to reorganize under the laws of State B, on November 15, 2024, Corporation X forms Corporation Y (a State B corporation) and merges into Corporation Y in a transaction (Corporation X Redomiciliation) that qualifies as an F reorganization. On the date of the Corporation X Redomiciliation, the fair market value of Corporation X's stock is $100x. Shareholder A owns $25x of Corporation X's outstanding stock. In the Corporation X Redomiciliation, Shareholder A transfers all its Corporation X stock to Corporation X in exchange for $25x of cash, which is treated for Federal income tax purposes as an unrelated, separate transaction from the Corporation X Redomiciliation to which section 302(a) applies (Shareholder A Redemption). *See* § 1.368–2(m)(3)(iii) of this chapter. The remaining Corporation X shareholders exchange their Corporation X stock for Corporation Y stock as part of the Corporation X Redomiciliation.

(ii) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by Shareholder A of its Corporation X stock is a repurchase by Corporation X in the amount of $25x because it is a section 317(b) redemption. *See* § 58.4501–2(e)(2)(i). In addition, the exchange by Corporation X's other shareholders of their Corporation X stock for Corporation Y stock is a repurchase by Corporation X in the amount of $75x because that exchange is an economically similar transaction. *See* § 58.4501–2(e)(2)(ii) and (e)(4)(iii). These repurchases occur on November 15, 2024 (that is, the date on which the Corporation X shareholders transfer their Corporation X stock to Corporation X as part of the transaction). *See* § 58.4501–2(g)(1) and (2). The total amount of these repurchases by Corporation X is $100x, which equals the sum of $25x (the fair market value of the Corporation X stock redeemed in the Shareholder A Redemption on the date of the redemption) and $75x (the aggregate fair market value of the Corporation X stock on the date that stock is exchanged by the remaining Corporation X shareholders as part of the Corporation X Redomiciliation (that is, November 15, 2024)). *See* § 58.4501–2(h)(1).

(iii) *Analysis regarding impact of Shareholder A Redemption and Corporation X Redomiciliation on Corporation X's stock repurchase excise tax base.* Corporation X's stock repurchase excise tax base for its 2024 taxable year initially is increased by $100x on account of the Shareholder A Redemption and the Corporation X Redomiciliation. *See* § 58.4501–2(c)(1)(i). Under the reorganization exception, the fair market value of the Corporation X stock exchanged by the Corporation X shareholders for Corporation Y stock in the Corporation X Redomiciliation (that is, $75x) is a qualifying property repurchase that reduces the amount of Corporation X's stock repurchase excise tax base. *See* §§ 58.4501–2(c)(1)(ii) and 58.4501–3(c)(3). Accordingly, Corporation X's stock repurchase excise tax base for its 2024 taxable year is increased by $25x ($25x repurchase + ($75x repurchase − $75x exception) = $25x) because of the Corporation X Redomiciliation.

(iv) *Analysis regarding impact of Corporation X Redomiciliation on Corporation Y's stock repurchase excise tax base.* Corporation Y's transfer of the $75x of its stock to Corporation X in the Corporation X Redomiciliation is disregarded for purposes of the netting rule because Corporation Y's issuance of that stock is part of a transaction to which the reorganization exception applies. *See* § 58.4501–4(f)(3) (disregarding such types of issuances to ensure no double benefit). Specifically, Corporation Y's transfer of its stock to Corporation X is disregarded for purposes of the netting rule because the Corporation Y

stock constitutes property permitted to be received under section 354 without the recognition of gain, the Corporation Y stock is used by a covered corporation (that is, Corporation X) to repurchase its stock in a transaction that is a repurchase under § 58.4501–2(e)(4)(iii), and the repurchase by Corporation X is not included in Corporation X's stock repurchase excise tax base for its 2024 taxable year because it is a qualifying property repurchase. *See id.* Therefore, Corporation Y does not take into account any of the $75x of its stock transferred to Corporation X in computing Corporation Y's stock repurchase excise tax base for its 2024 taxable year under § 58.4501–4(f)(2)(i).

(11) *Example 11: Section 355 split-off*—(i) *Facts.* Corporation X owns all the stock of a pre-existing subsidiary (Controlled). On December 1, 2024, Corporation X distributes all the stock of Controlled and $20x of cash to certain of its shareholders (Participating Shareholders) in exchange for $100x of Corporation X stock in a split-off (Corporation X Split-Off). On the date of the Corporation X Split-Off, the Corporation X stock has a fair market value of $100x, and the Controlled stock has a fair market value of $80x.

(ii) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Participating Shareholders of their Corporation X stock for the $80x of Controlled stock and $20x of cash in the Corporation X Split-Off is a repurchase by Corporation X because the exchange is an economically similar transaction. *See* § 58.4501–2(e)(2)(ii) and (e)(4)(iv). This repurchase occurs on December 1, 2024 (that is, the date on which the Participating Shareholders exchange their Corporation X stock as part of the Corporation X Split-Off). *See* § 58.4501–2(g)(2). The amount of the repurchase by Corporation X is $100x, which equals the aggregate fair market value of the Corporation X stock on the date the stock is exchanged by the Participating Shareholders in the Corporation X Split-Off (that is, December 1, 2024). *See* § 58.4501–2(h)(1).

(iii) *Analysis regarding impact of Corporation X Split-Off on Corporation X's stock repurchase excise tax base.* Corporation X's stock repurchase excise tax base for its 2024 taxable year initially is increased by $100x on account of the Corporation X Split-Off. However, under the reorganization exception, the fair market value of the Corporation X stock exchanged by the Participating Shareholders for Controlled stock in the Corporation X Split-Off (that is, $80x) is a qualifying property repurchase that reduces the amount of Corporation X's stock repurchase excise tax base. *See* §§ 58.4501–2(c)(1)(ii) and 58.4501–3(c)(4). The fair market value of the Corporation X stock exchanged by the Participating Shareholders for the $20x of cash in the Corporation X Split-Off does not qualify for the reorganization exception. *See* § 58.4501–3(c). Therefore, Corporation X's stock repurchase excise tax base for its 2024 taxable year is increased by $20x ($100x repurchase − $80x exception = $20x) as a result of the Corporation X Split-Off.

(12) *Example 12: Section 355 split-off as part of a D reorganization*—(i) *Facts.* The facts are the same as in paragraph (b)(11)(i) of this section (*Example 11*), except that Controlled is a newly formed corporation, and the Corporation X Split-Off is carried out as part of a transaction qualifying as a D reorganization in which Corporation X transfers assets to Controlled.

(ii) *General analysis.* Except as described in paragraph (b)(12)(iii) of this section, the analysis is the same as in paragraphs (b)(11)(ii) and (iii) of this section (*Example 11*).

(iii) *Analysis regarding Controlled's stock repurchase excise tax base.* Controlled's transfer of $80x of its stock to Corporation X in the Corporation X Split-Off is disregarded for purposes of the netting rule because Controlled's issuance of that stock is part of a transaction to which the reorganization exception applies. *See* § 58.4501–4(f)(3) (disregarding such types of issuances to ensure no double benefit). Specifically, Controlled's transfer of its stock to Corporation X is disregarded for purposes of the netting rule because the Controlled stock constitutes property permitted to be received under section 355 without the recognition of gain, the Controlled stock is used by a covered corporation (that is, Corporation X) to repurchase its stock in a transaction that is a repurchase under § 58.4501–2(e)(4)(iv), and the repurchase by Corporation X is not included in Corporation X's stock repurchase excise tax base for its 2024 taxable year because it is a qualifying property repurchase. *See id.* Controlled's transfer of its stock to Corporation X also is disregarded for purposes of the netting rule because Controlled is not a covered corporation at the time of the transfer. *See* § 58.4501–2(d)(1). Therefore, Controlled does not take into account any of the $80x of its stock transferred to Corporation X in computing Controlled's stock repurchase excise tax base for its 2024 taxable year under § 58.4501–4(b)(1).

(13) *Example 13: Spin-off*—(i) *Facts.* The facts are the same as in paragraph (b)(11)(i) of this section (*Example 11*), except that Corporation X distributes the Controlled stock and cash to its shareholders pro rata without the shareholders exchanging any Corporation X stock (Corporation X Spin-Off).

(ii) *Analysis.* The Corporation X Spin-Off is not a repurchase by Corporation X. *See* § 58.4501–2(e)(5)(iii).

(14) *Example 14: Section 355 spin-off as part of a D reorganization*—(i) *Facts.* The facts are the same as in paragraph (b)(13)(i) of this section (*Example 13*), except that Controlled is a newly formed corporation, the Corporation X Spin-Off is carried out as part of a transaction qualifying as a D reorganization in which Corporation X transfers assets to Controlled, and Corporation X receives the $20x of cash from Controlled and distributes the cash to certain of Corporation X's shareholders in exchange for Corporation X stock.

(ii) *Analysis regarding Corporation X.* The distribution by Corporation X of the $80x of stock of Controlled in the Corporation X Spin-Off is not a repurchase by Corporation X. *See* § 58.4501–2(e)(5)(iii)(A). The distribution by Corporation X of the $20x of cash in exchange for Corporation X stock is a repurchase. *See* § 58.4501–2(e)(5)(iii)(B).

(iii) *Analysis regarding Controlled's stock repurchase excise tax base.* Controlled's transfer of the $80x of its stock to Corporation X is disregarded for purposes of the netting rule. *See* § 58.4501–4(f)(9) (providing that any stock issued by a controlled corporation in a distribution qualifying under section 355 (or so much of section 356 as relates to section 355) that is not a split-off is disregarded for purposes of the netting rule).

(15) *Example 15: Repurchase pursuant to an accelerated share repurchase agreement*—(i) *Facts.* On October 10, 2022, Corporation X entered into an accelerated share repurchase (ASR) agreement with an investment bank (Bank). Under the terms of the ASR agreement, Bank agrees to deliver a number of shares of Corporation X stock to Corporation X during the term of the ASR, in an amount determined by reference to the price of Corporation X stock on specified days during the term of the ASR. Pursuant to the terms of the ASR agreement, Corporation X paid Bank a prepayment amount. Bank borrowed 80 shares of Corporation X stock from a party not related to Bank or Corporation X. Pursuant to the terms of the ASR agreement, Bank delivered 80 shares of Corporation X stock to Corporation X on October 12, 2022. On final settlement of the ASR, Bank may be required to deliver additional shares of Corporation X stock to Corporation X or Corporation X may be required to make a payment to Bank. The terms of the ASR agreement and the facts and circumstances cause ownership of the 80 shares to transfer from Bank to Corporation X for Federal income tax purposes at the time of delivery (that is, October 12, 2022). The agreement will settle in 2023. On February 1, 2023, Bank delivers an additional 20 shares to Corporation X in final settlement of the ASR agreement. For Federal income tax purposes, ownership of those 20 shares is treated as transferring from Bank to Corporation X at the time of delivery (that is, February 1, 2023).

(ii) *Analysis.* Corporation X is treated as repurchasing 80 shares of Corporation X stock on October 12, 2022 (that is, the date on which ownership of the 80 shares delivered by Bank transferred from Bank to Corporation X for Federal income tax purposes). *See* § 58.4501–2(g)(1). However, the repurchase by Corporation X of the 80 shares of Corporation X stock does not increase Corporation X's stock repurchase excise tax base for its 2023 taxable year because the repurchase occurred prior to January 1, 2023. *See* § 58.4501–2(c)(3); *see also* section 10201(d) of the IRA (providing that the stock repurchase excise tax applies to repurchases after December 31, 2022). The delivery by Bank to Corporation X of 20 shares of Corporation X stock on February 1, 2023, constitutes a repurchase because, for Federal income tax purposes, the terms of the ASR agreement and the facts and circumstances cause ownership of those shares to transfer from Bank to Corporation X on that date. *See* § 58.4501–2(g)(1). Therefore, the repurchase by Corporation X of those 20 shares of Corporation X stock

increases Corporation X's stock repurchase excise tax base for its 2023 taxable year.

(16) *Example 16: Distribution in complete liquidation of a covered corporation*—(i) *Facts.* Corporation X adopts a plan of complete liquidation that becomes effective on March 1, 2024 (Corporation X Liquidation). Corporation X has 100 shares of stock outstanding. On April 1, 2024, all shareholders of Corporation X receive a liquidating distribution by Corporation X in full payment for their Corporation X stock. On the date on which Corporation X distributes all its corporate assets to its shareholders in complete liquidation (that is, April 1, 2024), Corporation X stock is trading at $1x per share. Each distribution in complete liquidation is subject to section 331.

(ii) *Analysis.* A distribution in complete liquidation of a covered corporation (that is, Corporation X) to which section 331 (but not section 332(a)) applies is not a repurchase by the covered corporation. *See* § 58.4501–2(e)(5)(i). Therefore, none of the distributions by Corporation X in complete liquidation is a repurchase by Corporation X, and Corporation X's stock repurchase excise tax for its 2024 taxable year is not increased because of the Corporation X Liquidation.

(17) *Example 17: Complete liquidation of a covered corporation to which sections 331 and 332(a) both apply*—(i) *Facts.* The facts are the same as in paragraph (b)(16)(i) of this section (*Example 16*), except that one of Corporation X's shareholders (Corporation Z) is an 80-percent distributee (as defined in section 337(c) of the Code), and the liquidating distribution by Corporation X to Corporation Z as part of the Corporation X Liquidation qualifies as a complete liquidation under section 332(a).

(ii) *Analysis.* In the case of a complete liquidation of a covered corporation, if sections 331 and 332(a), respectively, apply to component distributions of the complete liquidation, a distribution to which section 331 applies is a repurchase by the covered corporation, and the distribution to which section 332(a) applies is not a repurchase by the covered corporation. *See* § 58.4501–2(e)(4)(v). Therefore, as a result of the component liquidating distributions of the Corporation X Liquidation to which section 331 applies, Corporation X repurchased 20 shares of its stock on April 1, 2024. The Corporation X Liquidation results in a $20x increase in Corporation X's stock repurchase excise tax base for its 2024 taxable year because the fair market value of Corporation X's stock on the date of repurchase (that is, April 1, 2024) was $1x per share (20 shares x $1x = $20x). *See* § 58.4501–2(h)(1).

(18) *Example 18: Acquisition by disregarded entity*—(i) *Facts.* Corporation X owns all the interests in LLC, a domestic limited liability company that is disregarded as an entity separate from its owner for Federal tax purposes (disregarded entity) under § 301.7701–3 of this chapter. On May 31, 2024, LLC purchases shares of Corporation X's stock for cash from an unrelated shareholder.

(ii) *Analysis.* Because LLC is a disregarded entity, the May 31, 2024, acquisition of Corporation X stock is treated as an acquisition by Corporation X. Accordingly, the acquisition is a section 317(b) redemption and therefore a repurchase. *See* § 58.4501–2(e)(2)(i). Section 301.7701–2(c)(2)(v) of this chapter (treating disregarded entities as corporations for purposes of certain excise taxes) does not apply to treat LLC as a corporation because neither chapter 37 of the Code nor section 4501 is described in § 301.7701–2(c)(2)(v)(A) of this chapter.

(19) *Example 19: Reverse triangular merger*—(i) *Facts.* On October 1, 2024, Corporation X acquires all of Target's outstanding stock (Target Stock Acquisition) in a transaction that qualifies as a reverse triangular merger. To effectuate the Target Stock Acquisition, Corporation X causes the following steps to occur on the same day. First, Corporation X contributes $80x of Corporation X stock and $20x of cash (Merger Consideration) to a newly formed corporation (Merger Sub). Second, Merger Sub merges into Target in a statutory merger, with Target surviving (Reverse Triangular Merger). On the date of the Reverse Triangular Merger (that is, October 1, 2024), the fair market value of Target's outstanding stock is $100x. In the Reverse Triangular Merger, $80x of Target stock is exchanged for Corporation X stock, and $20x of Target stock is exchanged for $20x of cash.

(ii) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Target shareholders of their Target stock for the Merger Consideration is a repurchase by Target because that exchange is an economically similar transaction. *See* § 58.4501–2(e)(2)(ii) and (e)(4)(i). The repurchase occurs on October 1, 2024 (that is, the date on which the Target shareholders exchange their Target shares as part of the Reverse Triangular Merger). *See* § 58.4501–2(g)(2). The amount of the repurchase is $100x, which equals the aggregate fair market value of the Target stock on the date the stock is exchanged by the Target shareholders as part of the Reverse Triangular Merger (that is, October 1, 2024). *See* § 58.4501–2(h)(1).

(iii) *Analysis regarding impact of Reverse Triangular Merger on Target's stock repurchase excise tax base.* Target's stock repurchase excise tax base for its 2024 taxable year initially is increased by $100x on account of the Reverse Triangular Merger. *See* § 58.4501–2(c)(1)(i). Under the reorganization exception, the fair market value of the Target stock exchanged by the Target shareholders for Corporation X stock in the Reverse Triangular Merger (that is, $80x) is a qualifying property repurchase that reduces the amount of Target's stock repurchase excise tax base. *See* §§ 58.4501–2(c)(1)(ii) and 58.4501–3(c)(1) (regarding acquisitive reorganizations). However, the fair market value of the Target stock exchanged by the Target shareholders for the $20x of cash in the Reverse Triangular Merger does not qualify for the reorganization exception. *See* § 58.4501–3(c). In addition, any Target stock that is deemed to be issued by Target to Merger Sub in exchange for the Merger Consideration is disregarded for purposes of the netting rule. *See* § 58.4501–4(f)(7). Therefore, Target's stock repurchase excise tax base for its 2024 taxable year is increased by $20x ($100x repurchase − $80x exception = $20x) as a result of the Reverse Triangular Merger.

(iv) *Analysis regarding impact of Reverse Triangular Merger on Corporation X's stock repurchase excise tax base.* Corporation X's issuance of Corporation X stock in the Reverse Triangular Merger is disregarded for purposes of the netting rule because Corporation X's issuance of that stock is part of a transaction to which the reorganization exception applies. *See* § 58.4501–4(f)(3) (disregarding such types of issuances to ensure no double benefit). Specifically, Corporation X's issuance of Corporation X stock is disregarded for purposes of the netting rule because the Corporation X stock constitutes property permitted to be received under section 354 without the recognition of gain, the Corporation X stock is used by a covered corporation (that is, Target) to repurchase its stock in a transaction that is a repurchase under § 58.4501–2(e)(4)(i), and the repurchase by Target is not included in Target's stock repurchase excise tax base because it is a qualifying property repurchase. *See id.* Therefore, Corporation X does not take into account any of the $80x of its stock issued in the Reverse Triangular Merger in computing its stock repurchase excise tax base for its 2024 taxable year under § 58.4501–4(b)(1).

(20) *Example 20: Multiple repurchases and contributions of same class of stock*—(i) *Facts.* On January 15, 2024, Corporation X repurchases 100 shares of its Class A stock that have an aggregate fair market value of $1,000x ($10x per share). On September 16, 2024, Corporation X repurchases 50 shares of its Class A stock that have an aggregate fair market value of $200x ($4x per share). Corporation X contributes to its ESOP 75 shares of its Class A stock on March 15, 2024, and 75 shares of its Class A stock on October 15, 2024.

(ii) *Analysis.* Corporation X's stock repurchase excise tax base for its 2024 taxable year initially is increased by $1,200x ($1,000x + $200x = $1,200x) as a result of the repurchases of its Class A stock. *See* § 58.4501–2(c)(1)(i). Under the exception for stock contributions to an employer-sponsored retirement plan, Corporation X's stock contributions reduce the amount of Corporation X's stock repurchase excise tax base. *See* §§ 58.4501–2(c)(1)(ii) and 58.4501–3(d). The amount of the reduction is determined by dividing the aggregate fair market value of shares of Class A stock repurchased by the number of shares repurchased ($1,200x/150 shares = $8 per share) and multiplying the number of shares contributed by the average price of the repurchased shares (150 shares x $8 per share = $1,200x). *See* § 58.4501–3(d)(3)(i). Therefore, Corporation X's stock repurchase excise tax base for its 2024 taxable year is $0 ($1,200x repurchase − $1,200x exception = $0).

(21) *Example 21: Multiple repurchases and contributions of different classes of stock*—(i) *Facts.* The facts are the same as in paragraph (b)(20)(i) of this section (*Example 20*), except that Corporation X has Class B stock and contributes its Class B stock rather than its Class A stock to its ESOP. On October 15, 2024, Corporation X contributes to its ESOP

75 shares of its Class B stock that have an aggregate fair market value of $1,000x. On December 16, 2024, Corporation X contributes to its ESOP 25 shares of its Class B stock that have an aggregate fair market value of $500x.

(ii) *Analysis.* Corporation X's reduction in computing its stock repurchase excise tax base is equal to the sum of the fair market values of the different class of stock at the time 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* § 58.4501–3(d)(4)(ii). Therefore, Corporation X's stock repurchase excise tax base for its 2024 taxable year is $0 ($1,200x repurchase − $1,200x exception = $0).

(22) *Example 22: Treatment of contributions after the taxable year*—(i) *Facts.* Corporation X repurchases 200 shares of its stock on December 31, 2024, for $200x ($1x per share). Corporation X has no other repurchases in 2024. On February 2, 2026, Corporation X contributes 200 shares of stock to its ESOP. Corporation X treats the contribution as if it had been received for the 2024 calendar year for plan allocation purposes. *See* § 58.4501–3(d)(5)(ii).

(ii) *Analysis.* Corporation X may use the contribution of the 200x shares of its stock on February 2, 2026, to reduce its $200x stock repurchase excise tax base for 2024. *See* § 58.4501–3(d)(5)(ii).

(23) *Example 23: Becoming a covered corporation*—(i) *Facts.* As of January 1, 2024, all of Corporation X's stock is privately held (and, therefore, none of Corporation X's stock is traded on an established securities market). On February 15, 2024, Corporation X purchases 10 shares of its stock for $5x of cash ($.50x per share). On April 1, 2024, Corporation X issues 100 shares of its stock to the public (Public Shareholders), at which time Corporation X's stock begins trading on an established securities market. On November 15, 2024, when Corporation X stock is trading at $2x per share, Corporation X purchases 60 shares of its stock for $120x of cash.

(ii) *Analysis regarding purchase on February 15, 2024.* Corporation X becomes a covered corporation at the beginning of the day on April 1, 2024 (the initiation date). *See* § 58.4501–2(d)(1). Accordingly, Corporation X's purchase of 10 shares of its stock for $5x of cash on February 15, 2024, is not a repurchase. *See* § 58.4501–1(b)(24). Thus, the purchase on February 15, 2024, is not included in Corporation X's stock repurchase excise tax base for its 2024 taxable year.

(iii) *Analysis regarding issuance on April 1, 2024.* Corporation X is a covered corporation on April 1, 2024. *See* § 58.4501–2(d)(1). Accordingly, the Corporation X stock issued to the Public Shareholders on that date is stock of a covered corporation for purposes of the netting rule. *See* § 58.4501–4(b)(1). As a result, Corporation's stock repurchase excise tax base for its 2024 taxable year is reduced by $100x. *See* § 58.4501–2(c)(1)(iii).

(iv) *Analysis regarding purchase on November 15, 2024.* Corporation X is a covered corporation on November 15, 2024. Accordingly, Corporation X's purchase of 60x shares of its stock on that date is a repurchase because the transaction is a section 317(b) redemption (that is, a redemption within the meaning of section 317(b) with regard to the stock of a covered corporation). *See* §§ 58.4501–1(b)(24) and 58.4501–2(e)(2)(i). For purposes of computing Corporation X's stock repurchase excise tax base, the fair market value of the 60 shares of stock repurchased on November 15, 2024, is the aggregate market price of those shares on that repurchase date, or $120x ($2x per share x 60 shares = $120x). *See* § 58.4501–2(g)(1). Accordingly, Corporation's stock repurchase excise tax base for its 2024 taxable year is increased by $120x. *See* § 58.4501–2(c)(1)(i).

(24) *Example 24: Actual redemption in partial liquidation*—(i) *Facts.* Corporation X is actively engaged in the conduct of Businesses A and B. Each business constitutes a qualified trade or business within the meaning of section 302(e)(3). On September 1, 2024, pursuant to a plan of partial liquidation adopted in the same taxable year, Corporation X sells Business B for $100x and distributes the proceeds to its shareholders pro rata in redemption of $100x of Corporation X stock. The transaction qualifies as a distribution in partial liquidation under section 302(b)(4) and (e).

(ii) *Analysis.* Corporation X's distribution in partial liquidation is a section 317(b) redemption. In addition, Corporation X's distribution in partial liquidation is not included in the exclusive list of transactions under § 58.4501–2(e)(3) that are treated as a section 317(b) redemption but are not a repurchase. Accordingly, the distribution in partial liquidation is a repurchase. *See* § 58.4501–2(e)(2)(i). Therefore, as a result of the distribution, Corporation X's stock repurchase excise tax base for its 2024 taxable year is increased by $100x. *See* § 58.4501–2(c)(1)(i).

(25) *Example 25: Constructive redemption in partial liquidation*—(i) *Facts.* The facts are the same as in paragraph (b)(24)(i) of this section (*Example 24*), except that the shareholders of Corporation X surrender no stock in exchange for the proceeds from the sale of Business B. For Federal income tax purposes, a constructive redemption of stock is deemed to occur, and the transaction qualifies as a distribution in partial liquidation under section 302(b)(4) and (e).

(ii) *Analysis.* The analysis is the same as in paragraph (b)(24)(ii) of this section (*Example 24*).

(26) *Example 26: Physical settlement of call option contract*—(i) *Facts.* On March 1, 2024, Corporation X issues an option that entitles the holder to buy 100 shares of Corporation X stock from Corporation X for $150x ($1.50x per share). On the date the option is issued, Corporation X stock is trading at $1x per share. On November 1, 2024, when Corporation X stock is trading at $2x per share, the holder pays Corporation X $150x to exercise the option, and Corporation X issues 100 shares of Corporation X stock to the holder, at which time ownership of the shares transfers to the holder for Federal income tax purposes.

(ii) *Analysis.* For purposes of computing Corporation X's stock repurchase excise tax base, Corporation X is treated as issuing 100 shares of Corporation X stock on November 1, 2024. *See* § 58.4501–4(d)(1). The fair market value of that stock is its aggregate market price on the date of issuance by Corporation X, or $200x ($2x per share x 100 shares = $200x). *See* § 58.4501–4(e)(1). Accordingly, the issuance is a reduction of $200x in computing Corporation X's stock repurchase excise tax base for its 2024 taxable year. *See* § 58.4501–2(c)(1)(iii).

(27) *Example 27: Net cash settlement of call option contract*—(i) *Facts.* The facts are the same as in paragraph (b)(26)(i) of this section (*Example 26*), except that Corporation X net cash settles the option by paying the holder $50x.

(ii) *Analysis.* The net cash settlement is disregarded for purposes of the netting rule. *See* § 58.4501–4(f)(12) (disregarding the settlement of an option contract with respect to stock of a covered corporation using any consideration other than stock of the covered corporation).

(28) *Example 28: Physical settlement of put option contract*—(i) *Facts.* On April 1, 2024, Corporation X issues an option entitling the holder to sell 100 shares of Corporation X stock to Corporation X for $100x ($1x per share). On the date the option is issued, Corporation X stock is trading at $1.25x per share. On October 1, 2024, when Corporation X stock is trading at $0.75x per share, the holder exercises the option, and Corporation X purchases 100 shares of Corporation X stock for $100x, at which time ownership of the shares transfers to Corporation X.

(ii) *Analysis.* Corporation X's purchase on October 1, 2024, is a repurchase because it is a section 317(b) redemption. For purposes of computing Corporation X's stock repurchase excise tax base, the fair market value of the repurchased stock is its aggregate market price on the date on which ownership of the stock transfers to Corporation X for Federal income tax purposes (October 1, 2024), or $75x ($0.75x per share x 100 shares = $75x). *See* § 58.4501–2(g)(1) and (h)(1). Accordingly, the repurchase is an increase of $75x in computing Corporation X's stock repurchase excise tax base for its 2024 taxable year. *See* § 58.4501–2(c)(1)(i).

(29) *Example 29: Net cash settlement of put option contract*—(i) *Facts.* The facts are the same as in paragraph (b)(28)(i) of this section (*Example 28*), except that Corporation X net cash settles the put option by paying the holder $25x.

(ii) *Analysis.* The net cash settlement is not a repurchase. *See* § 58.4501–2(e)(5)(iv) (providing that net cash settlement of an option contract with respect to stock of a covered corporation is not a repurchase by the covered corporation).

(30) *Example 30: Indirect ownership*—(i) *Facts.* Corporation X owns 60 percent of the only class of stock of Sub 1, a domestic corporation. Sub 1 owns 60 percent of the only class of stock of Sub 2, which is also a domestic corporation. On October 15, 2024, Sub 2 purchases stock of Corporation X with a market price of $100,000.

(ii) *Analysis.* The determination of whether Sub 2 is a specified affiliate of Corporation X is relevant at the time Sub 2 purchases Corporation X stock on October 15, 2024, and

therefore must be made at that time. *See* § 58.4501–2(f)(2)(i). Under § 58.4501–2(f)(2)(ii), Corporation X indirectly owns 36 percent (60% x 60% = 36%) of the stock of Sub 2. Sub 2 is not a specified affiliate of Corporation X, because Corporation X does not own, directly or indirectly, more than 50 percent of the stock of Sub 2. *See* § 58.4501–1(b)(25). Accordingly, Sub 2's purchase of Corporation X stock on October 15, 2024, is not a repurchase under § 58.4501–2(f)(1).

(31) *Example 31: Constructive specified affiliate acquisition*—(i) *Facts.* The facts are the same as in paragraph (b)(30)(i) of this section (*Example 30*), except that, on January 15, 2025, Sub 1 acquires an additional 40 percent of the stock of Sub 2.

(ii) *Analysis.* Because Sub 2 owns stock of Corporation X, the determination of whether Sub 2 is a specified affiliate of Corporation X is relevant at the time Sub 1 purchases acquires additional stock of Sub 2 on January 15, 2025. *See* § 58.4501–2(f)(2)(i). Under § 58.4501–2(f)(2)(ii), Corporation X indirectly owns 60 percent (60% x 100% = 60%) of the stock of Sub 2. Accordingly, Sub 2 becomes a specified affiliate of Corporation X on January 15, 2025, because Corporation X owns, directly or indirectly, more than 50 percent of the stock of Sub 2. *See* § 58.4501–1(b)(25). Because Sub 2 owns stock of Corporation X that Sub 2 acquired after December 31, 2022, and Sub 2 became a specified affiliate of Corporation X after Sub 2 acquired the stock of Corporation X, the stock of Corporation X owned by Sub 2 is treated as repurchased by Corporation X on January 15, 2025. *See* § 58.4501–2(f)(3)(i) and (g)(4).

(32) *Example 32: Restricted stock provided to a service provider*—(i) *Facts.* Individual M provides services to Corporation X. In 2024, as compensation for Individual M's services, Corporation X transfers to individual M 100 shares of Corporation X restricted stock with an aggregate fair market value of $500x ($5x per share). The shares vest in 2028. Individual M does not make an election under section 83(b). In 2028, Corporation X withholds from Individual M's other wages amounts that are required to pay the income tax and employment tax withholding obligations arising from the stock transfer. The shares have a fair market value of $7x per share when they vest.

(ii) *Analysis.* Corporation X is treated as issuing 100 shares of stock to Individual M when they become substantially vested in 2028. *See* § 58.4501–4(d)(2)(i). The fair market value of the shares issued is $700x (100 shares x $7x per share = $700x). Accordingly, the issuance is a reduction of $700x in computing corporation X's stock repurchase excise tax base for its 2028 taxable year.

(33) *Example 33: Restricted stock provided to a service provider with section 83(b) election*—(i) *Facts.* The facts are the same as in paragraph (b)(32)(i) of this section (*Example 32*), except that Individual M makes a valid election under section 83(b) to include the fair market value of the shares of restricted stock in gross income when the shares are transferred.

(ii) *Analysis.* Corporation X is treated as issuing 100 shares of stock to Individual M when the shares are transferred in 2024. *See* § 58.4501–4(d)(2)(iii). The fair market value of the shares issued is $500x (100 shares x $5x per share = $500x). Accordingly, the issuance is a reduction of $500x in computing Corporation X's stock repurchase excise tax base for its 2024 taxable year. Corporation X is not treated as issuing stock to Individual M when the shares vest in 2028.

(34) *Example 34: Vested stock provided to a service provider with share withholding*—(i) *Facts.* Employee N is an employee of Corporation X. In 2024, as compensation for Employee N's services, Corporation X grants Employee N 100 restricted stock units (RSUs). Pursuant to the RSUs, if Employee N remains employed by Corporation X through December 31, 2027, Corporation X will transfer 100 shares of Corporation X stock to Employee N in January 2028. Employee N remains employed by Corporation X through December 31, 2027. In January 2028, when the shares have a fair market value of $5x per share, Corporation X initiates the transfer of 60 shares of Corporation X stock to Employee N and withholds 40 shares to satisfy its income tax and employment tax withholding obligations arising from Employee N vesting in the shares.

(ii) *Analysis.* Corporation X is treated as issuing 60 shares of stock to Employee N when the shares are transferred in 2028. *See* § 58.4501–4(d)(2)(i). The 40 shares of Corporation X stock withheld to satisfy Corporation X's withholding obligations are disregarded for purposes of the netting rule. *See* § 58.4501–4(f)(11)(i). The fair market value of the shares issued is $300x (60 shares x $5x per share = $300x). Accordingly, the issuance is a reduction of $300x in computing Corporation X's stock repurchase excise tax base for its 2028 taxable year.

(35) *Example 35: Stock option net exercise*—(i) *Facts.* Employee O is an employee of Corporation X. In 2024, in connection with the performance of services, Corporation X transfers to Employee O options to purchase 100 shares of Corporation X stock with an exercise price of $4x per share ($400x exercise price in total). The options are described in § 1.83–7 of this chapter and do not have a readily ascertainable fair market value. Employee O exercises the option to purchase 100 shares in 2026, when the fair market value is $5x per share. Corporation X withholds 80 shares to pay the $400x exercise price (80 shares x $5x per share = $400x).

(ii) *Analysis.* Corporation X is treated as issuing 20 shares of stock to Employee O when Employee O exercises the options in 2026. *See* § 58.4501–4(d)(2)(ii). The 80 shares of Corporation X stock withheld to pay the exercise price are disregarded for purposes of the netting rule. *See* § 58.4501–4(f)(11)(i). The fair market value of the shares issued is $100x (20 shares x $5x per share = $100x). Accordingly, the issuance is a reduction of $100x in computing Corporation X's stock repurchase excise tax base for its 2026 taxable year.

(36) *Example 36: Net share settlement not in connection with performance of services*—(i) *Facts.* Corporation X issues a call option to Individual A that entitles Individual A to buy 100 shares of Corporation X stock for $100x ($1x per share) from Corporation X for a limited time. The terms of the option require or permit net share settlement. On the date the option is issued, Corporation X stock is trading at $1x per share. On the date the option is exercised, Corporation X stock is trading at $1.25x per share. To settle the option, Individual A makes no payment to Corporation X, and Corporation X issues 20 shares of Corporation X stock (worth $25x).

(ii) *Analysis.* Corporation X is treated as issuing 20 shares with a fair market value of $25x. *See* § 58.4501–4(f)(11)(ii).

(37) *Example 37: Broker-assisted net exercise*—(i) *Facts.* The facts are the same as in paragraph (b)(35)(i) of this section (*Example 35*), except that, instead of Corporation X withholding shares to pay the exercise price, a third-party broker pays an amount equal to the exercise price (that is, $400x) to Corporation X. Corporation X transfers 100 shares of Corporation X stock to the third-party broker, which deposits the 100 shares into Employee O's account. The third-party broker then immediately sells 80 shares to recover the $400x exercise price paid to Corporation X (80 shares x $5x per share = $400x).

(ii) *Analysis.* Corporation X is treated as issuing 100 shares of stock to Employee O when Employee O exercises the options in 2026. *See* § 58.4501–4(c)(2) and (d)(1)(i). The fair market value of the shares issued is $500x (100 shares x $5x per share = $500x). Accordingly, the issuance is a reduction of $500x in computing Corporation X's stock repurchase excise tax base for its 2026 taxable year.

(38) *Example 38: Stock provided by a specified affiliate to an employee*—(i) *Facts.* Individual P is an employee of Corporation Y, which is a specified affiliate of Corporation X. In 2024, Corporation X transfers 100 shares of its stock to Individual P, when the stock is valued at $9x per share, in connection with Individual P's performance of services as an employee of Corporation Y.

(ii) *Analysis.* Under § 1.83–6(d) of this chapter, Corporation X is treated as contributing the stock to the capital of Corporation Y, which is treated as transferring the shares to Individual P as compensation for services. Corporation Y is treated as providing 100 shares to individual P. *See* § 58.4501–4(b)(1)(ii) and (f)(2)(iv). The fair market value of the shares provided is $900x (100 shares x $9x per share = $900x). Accordingly, the provision is a reduction of $900x in computing Corporation X's stock repurchase excise tax base for its 2024 taxable year.

(39) *Example 39: Stock provided by a specified affiliate to a nonemployee*—(i) *Facts.* The facts are the same as in paragraph (b)(38)(i) of this section (*Example 38*), except that Individual P provides services as a non-employee service provider of Corporation Y.

(ii) *Analysis.* Corporation Y is not treated as providing shares for purposes of the netting rule because P is a non-employee service provider. *See* § 58.4501–4(b)(1)(ii) and (f)(2)(iv). Accordingly, there is no reduction in Corporation X's stock repurchase excise tax base for its 2024 taxable year.

(40) *Example 40: Corporation treated as a domestic corporation under section 7874(b)*—(i) *Facts.* Corporation FB is a corporation the stock of which is traded on an established securities market (within the meaning of section 7704(b)(1) of the Code) and that is created or organized in a foreign jurisdiction. Corporation FB is treated as a domestic corporation under section 7874(b).

(ii) *Analysis.* Corporation FB is treated for purposes of this title as a domestic corporation under section 7874(b). Corporation FB is a covered corporation because it is treated for purposes of this title as a domestic corporation and its stock is traded on an established securities market. *See* § 58.4501–1(b)(6).

§ 58.4501–6 Applicability dates.

(a) *In general.* Except as provided in paragraph (b) of this section, §§ 58.4501–1 through 58.4501–5 apply to—

(1) Repurchases of stock of a covered corporation occurring after December 31, 2022, and during taxable years ending after December 31, 2022; and

(2) Issuances and provisions of stock of a covered corporation occurring during taxable years ending after December 31, 2022.

(b) *Exceptions*—(1) *Applicability date for certain rules.* Sections 58.4501–2(d), (e)(4)(vi), (f)(2) and (3), (g)(4), (h)(2)(v), and (h)(3)(ii), 58.4501–3(g)(3) and (4), 58.4501–4(e)(2)(v), (e)(3)(ii), (f)(2)(ii), and (f)(8), (9), and (13) apply to—

(i) Repurchases of stock of a covered corporation occurring after April 12, 2024, and during taxable years ending after April 12, 2024; and

(ii) Issuances and provisions of stock of a covered corporation occurring after April 12, 2024, and during taxable years ending after April 12, 2024.

(2) *Special rules for acquisitions or repurchases of stock of certain foreign corporations. See* § 58.4501–7(r) for applicability dates for the provisions of § 58.4501–7 and the provisions of § 58.4501–1 as applicable to transactions subject to § 58.4501–7.

§ 58.4501–7 Special rules for acquisitions or repurchases of stock of certain foreign corporations.

(a) *Scope.* This section provides rules regarding the application of section 4501(d) of the Code. Paragraph (b) of this section provides definitions applicable for purposes of this section. Paragraph (c) of this section provides rules for computing a section 4501(d) covered corporation's section 4501(d) excise tax liability. Paragraph (d) of this section provides certain coordination rules related to section 4501(d)(2). Paragraph (e) of this section provides rules that apply if an applicable specified affiliate funds certain acquisitions or repurchases of stock of an applicable foreign corporation. Paragraph (f) of this section provides certain rules for determining the status of a corporation as an applicable foreign corporation or a covered surrogate foreign corporation. Paragraph (g) of this section provides certain rules for determining the status of a corporation or partnership as an applicable specified affiliate, a relevant entity of an applicable foreign corporation, or a specified affiliate of a covered surrogate foreign corporation. Paragraph (h) of this section provides rules for determining whether a foreign partnership is an applicable specified affiliate. Paragraph (i) of this section is reserved. Paragraph (j) of this section defines the terms AFC repurchase and CSFC repurchase. Paragraph (k) of this section provides rules for determining the date of a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase. Paragraph (l) of this section provides rules for determining the fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation that is repurchased or acquired. Paragraph (m) of this section provides rules regarding the application of certain section 4501(d) statutory exceptions. Paragraph (n) of this section provides rules regarding the section 4501(d) netting rule. Paragraph (o) of this section provides rules applicable before April 15, 2024. Paragraph (p) of this section illustrates the application of the rules of this section through examples involving section 4501(d)(1). Paragraph (q) of this section illustrates the application of the rules of this section through examples involving section 4501(d)(2). Paragraph (r) of this section provides the applicability date of this section.

(b) *Definitions*—(1) *Application of definitions in § 58.4501–1(b).* Any term used in this section (other than paragraph (o) of this section as provided in paragraph (o)(5) of this section) but not defined in paragraph (b)(2) of this section has the meaning provided in § 58.4501–1(b), provided, however, that:

(i) For all definitions provided in § 58.4501–1(b) other than those described in paragraph (b)(1)(ii) of this section, any reference in those definitions to a *covered corporation* is treated as a reference to a section 4501(d) covered corporation or applicable foreign corporation or covered surrogate foreign corporation as appropriate based on the context.

(ii) For the definitions of *employee* and *employer-sponsored retirement plan* provided in § 58.4501–1(b)(10) and (11), any reference to a *covered corporation* or its *specified affiliates* is treated solely as a reference to a section 4501(d) covered corporation.

(2) *Section 4501(d) definitions.* The definitions in this paragraph (b)(2) apply solely for purposes of this section (other than paragraph (o) of this section as provided in paragraph (o)(5) of this section).

(i) *AFC repurchase.* The term *AFC repurchase* has the meaning provided in paragraph (j) of this section.

(ii) *Allocable amount of a covered purchase.* The term *allocable amount of a covered purchase* has the meaning provided in paragraph (e)(5) of this section.

(iii) *Applicable foreign corporation.* The term *applicable foreign corporation* means any foreign corporation the stock of which is traded on an established securities market.

(iv) *Applicable specified affiliate.* The term *applicable specified affiliate* means a specified affiliate of an applicable foreign corporation, other than a foreign corporation or a foreign partnership (unless the partnership has a domestic entity as a direct or indirect partner, as determined under paragraph (h) of this section).

(v) *CSFC repurchase.* The term *CSFC repurchase* has the meaning provided in paragraph (j) of this section.

(vi) *Covered funding.* The term *covered funding* means a funding described in paragraph (e)(1) of this section.

(vii) *Covered purchase.* The term *covered purchase* means an AFC repurchase or an acquisition of stock of an applicable foreign corporation by a relevant entity.

(viii) *Covered surrogate foreign corporation.* The term *covered surrogate foreign corporation* means any surrogate foreign corporation (as determined under section 7874(a)(2)(B) of the Code by substituting *September 20, 2021* for *March 4, 2003* each place it appears) the stock of which is traded on an established securities market, including any successor to the surrogate foreign corporation (as determined under § 1.7874–12(a)(10) of this chapter), but only with respect to taxable years that include any portion of the applicable period with respect to such corporation under section 7874(d)(1).

(ix) *Direct partner.* The term *direct partner* has the meaning given the term in paragraph (h)(2)(i) of this section.

(x) *Domestic entity.* The term *domestic entity* means a domestic corporation, a domestic partnership, or a trust within the meaning of section 7701(a)(30)(E) of the Code.

(xi) *Downstream relevant entity.* The term *downstream relevant entity* means a relevant entity—

(A) 25 percent or more of the stock of which is owned (by vote or by value), directly or indirectly, by, individually or in aggregate, one or more applicable specified affiliates of an applicable foreign corporation; or

(B) 25 percent or more of the capital interests or profits interests of which is held, directly or indirectly, by, individually or in aggregate, one or more applicable specified affiliates of an applicable foreign corporation.

(xii) *Expatriated entity.* The term *expatriated entity* has the meaning given the term in section 7874(a)(2)(A) and § 1.7874–12(a)(8) of this chapter, including any successor (as determined under § 1.7874–12(a)(6) of this chapter).

(xiii) *Indirect partner.* The term *indirect partner* has the meaning given the term in paragraph (h)(2)(ii) of this section.

(xiv) *Relevant entity.* The term *relevant entity* means a specified affiliate of an applicable foreign corporation that is not an applicable specified affiliate of the applicable foreign corporation.

(xv) *Section 4501(d) covered corporation.* The term *section 4501(d) covered corporation* means either—

(A) An applicable specified affiliate of an applicable foreign corporation that is treated as a covered corporation under section 4501(d)(1)(A) by reason of a section 4501(d)(1) repurchase; or

(B) Any expatriated entity with respect to a covered surrogate foreign corporation that is treated as a covered corporation under section 4501(d)(2)(A) by reason of a section 4501(d)(2) repurchase.

(xvi) *Section 4501(d) de minimis exception.* The term *section 4501(d) de minimis exception* has the meaning provided in paragraph (c)(2)(i) of this section.

(xvii) *Section 4501(d) economically similar transaction.* The term *section 4501(d) economically similar transaction* has the meaning provided in paragraph (j)(4) of this section.

(xviii) *Section 4501(d) excise tax.* The term *section 4501(d) excise tax* has the meaning provided in paragraph (c)(1) of this section.

(xix) *Section 4501(d) excise tax base.* The term *section 4501(d) excise tax base* has the meaning provided in paragraph (c)(3)(i) of this section.

(xx) *Section 4501(d) netting rule.* The term *section 4501(d) netting rule* has the meaning provided in paragraph (n)(1) of this section.

(xxi) *Section 4501(d) reorganization exception.* The term *section 4501(d) reorganization exception* has the meaning provided in paragraph (m)(2) of this section.

(xxii) *Section 4501(d)(1) repurchase.* The term *section 4501(d)(1) repurchase* means—

(A) An acquisition of stock of an applicable foreign corporation by an applicable specified affiliate of the applicable foreign corporation from a person other than the applicable foreign corporation or a specified affiliate of the applicable foreign corporation; and

(B) A covered purchase to the extent an applicable specified affiliate is treated under paragraph (e) of this section as acquiring stock of the applicable foreign corporation that is repurchased or acquired, as applicable, in the covered purchase.

(xxiii) *Section 4501(d)(2) repurchase.* The term *section 4501(d)(2) repurchase* means a CSFC repurchase or an acquisition of stock of a covered surrogate foreign corporation by a specified affiliate of the covered surrogate foreign corporation.

(xxiv) *Section 4501(d) statutory exception.* The term *section 4501(d) statutory exception* has the meaning provided in paragraph (m)(1) of this section.

(c) *Computation of section 4501(d) excise tax liability for a section 4501(d) covered corporation*—(1) *Imposition of tax.* Except as provided in paragraph (c)(2) of this section (regarding the section 4501(d) de minimis exception), the amount of excise tax imposed pursuant to section 4501(d) on a section 4501(d) covered corporation (*section 4501(d) excise tax*) for a taxable year equals the product obtained by multiplying—

(i) The applicable percentage; by

(ii) The section 4501(d) excise tax base of the section 4501(d) covered corporation for the taxable year determined in accordance with paragraph (c)(3)(i) of this section.

(2) *Section 4501(d) de minimis exception*—(i) *In general.* A section 4501(d) covered corporation is not subject to the section 4501(d) excise tax with regard to a taxable year of the section 4501(d) covered corporation if, during that taxable year, the aggregate fair market value of all section 4501(d)(1) repurchases with respect to all applicable specified affiliates or all section 4501(d)(2) repurchases with respect to an expatriated entity, as applicable, does not exceed $1,000,000 (section 4501(d) de minimis exception).

(ii) *Determination.* A determination of whether the section 4501(d) de minimis exception applies with regard to a taxable year of a section 4501(d) covered corporation is made before applying—

(A) Any section 4501(d) statutory exception under paragraph (m) of this section; and

(B) Any adjustments pursuant to the section 4501(d) netting rule under paragraph (n) of this section.

(3) *Section 4501(d) excise tax base*—(i) *In general.* With regard to a section 4501(d) covered corporation, the term *section 4501(d) excise tax base* means the dollar amount (not less than zero) that is obtained by—

(A) Determining the aggregate fair market value of, as applicable, all section 4501(d)(1) repurchases or section 4501(d)(2) repurchases during the section 4501(d) covered corporation's taxable year;

(B) Reducing the amount determined under paragraph (c)(3)(i)(A) of this section by the fair market value of stock repurchased or acquired in all section 4501(d)(1) repurchases or section 4501(d)(2) repurchases, as applicable, during the section 4501(d) covered corporation's taxable year to the extent any section 4501(d) statutory exceptions apply in accordance with paragraph (m) of this section; and then

(C) Reducing the amount determined under paragraphs (c)(3)(i)(A) and (B) of this section by the aggregate fair market value of, as applicable, stock of the applicable foreign corporation or stock of the covered surrogate foreign corporation to the extent the section 4501(d) netting rule applies in accordance with paragraph (n) of this section.

(ii) *Taxable year determination*—(A) *In general.* The determinations under paragraph (c)(3)(i) of this section are made separately for each section 4501(d) covered corporation and for each taxable year of such section 4501(d) covered corporation.

(B) *No carrybacks or carryforwards.* Reductions under paragraphs (c)(3)(i)(B) and (C) of this section in excess of the amount determined under paragraph (c)(3)(i)(A) of this section with regard to a section 4501(d) covered corporation are not carried forward or backward to preceding or succeeding taxable years of the section 4501(d) covered corporation.

(4) *Section 4501(d)(1) repurchases or section 4501(d)(2) repurchases before January 1, 2023.* Section 4501(d)(1) repurchases and section 4501(d)(2) repurchases before January 1, 2023, are neither included in the section 4501(d) excise tax base of a section 4501(d) covered corporation nor taken into account in determining the applicability of the section 4501(d) de minimis exception.

(d) *Section 4501(d)(2) coordination rules*—(1) *Coordination rule for section 4501(d)(1) repurchases and section 4501(d)(2) repurchases.* To the extent any CSFC repurchase or acquisition of stock of a covered surrogate foreign

corporation would be both a section 4501(d)(1) repurchase and a section 4501(d)(2) repurchase absent this paragraph (d)(1), the CSFC repurchase or acquisition will only be a section 4501(d)(2) repurchase.

(2) *Coordination rule for multiple section 4501(d) covered corporations*—(i) *In general.* Except as provided in paragraph (d)(2)(ii) of this section, each section 4501(d) covered corporation with respect to a covered surrogate foreign corporation is liable for any section 4501(d) excise tax with respect to section 4501(d)(2) repurchases that occur during a taxable year of the section 4501(d) covered corporation.

(ii) *Full payment and reporting by a section 4501(d) covered corporation.* If there are multiple section 4501(d) covered corporations with respect to a covered surrogate foreign corporation, then provided that one of those section 4501(d) covered corporations pays the amount of section 4501(d) excise tax determined under paragraph (c)(1) of this section with respect to all section 4501(d)(2) repurchases relating to the covered surrogate foreign corporation and its specified affiliates that occur during the paying section 4501(d) covered corporation's taxable year and fulfills the filing obligations for the taxable year with respect to such section 4501(d)(2) repurchases, no other section 4501(d) covered corporation with respect to the covered surrogate foreign corporation is liable for section 4501(d) excise tax related to such section 4501(d)(2) repurchases.

(e) *Acquisitions and AFC repurchases of stock funded by applicable specified affiliates*—(1) *Principal purpose rule.* An applicable specified affiliate of an applicable foreign corporation is treated as acquiring stock of the applicable foreign corporation to the extent the applicable specified 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 (a *covered funding*). If a principal purpose of the covered funding is to fund, directly or indirectly, a covered purchase, then there is a principal purpose of avoiding the section 4501(d) excise tax. Whether a covered funding is described in this paragraph (e)(1) is determined based on all the facts and circumstances. A covered funding may be described in this paragraph (e)(1) regardless of whether the funding occurs before or after a covered purchase. This paragraph (e)(1) applies to fundings that occur on or after December 27, 2022, in taxable years ending after December 27, 2022.

(2) *Rebuttable presumption.* A principal purpose described in paragraph (e)(1) of this section is presumed to exist if the applicable specified affiliate funds by any means, directly or indirectly, a downstream relevant entity, and the funding occurs within two years of a covered purchase by or on behalf of the downstream relevant entity. The presumption described in this paragraph (e)(2) may be rebutted only if facts and circumstances clearly establish that there was not a principal purpose described in paragraph (e)(1) of this section. An applicable specified affiliate that takes the position that the presumption is rebutted must, for the taxable year that includes the date on which the applicable specified affiliate would, absent the rebuttal, be treated as acquiring stock of the applicable foreign corporation: (i) attach a statement to its stock repurchase excise tax return disclosing the relevant fundings and covered purchases and the facts that rebut the presumption, and (ii) provide any additional information that the stock repurchase excise tax return or the accompanying instructions require. *See* paragraph (e)(3) of this section for the date on which the applicable specified affiliate would, absent the rebuttal, be treated as acquiring stock of the applicable foreign corporation.

(3) *Date stock of applicable foreign corporation is treated as acquired.* To the extent an applicable specified affiliate is treated, by reason of a covered funding, as acquiring stock of an applicable foreign corporation that is acquired by a relevant entity or applicable foreign corporation in a covered purchase, such stock is treated as acquired by the applicable specified affiliate on the later of the date of the covered funding or the covered purchase.

(4) *Amount of stock of applicable foreign corporation treated as acquired.* The amount of stock of an applicable foreign corporation acquired in a covered purchase that is treated as acquired by an applicable specified affiliate is equal to the amount of the applicable specified affiliate's covered fundings that are allocated to the covered purchase under paragraph (e)(7) of this section.

(5) *Rules for determining the allocable amount of a covered purchase.* The *allocable amount of a covered purchase* is equal to the aggregate fair market value of the shares repurchased or acquired in the covered purchase (as determined in accordance with paragraph (l) of this section), reduced by the amount described in paragraph (m)(2), (4), or (6) of this section, as applicable.

(6) *Priority rule for covered fundings.* The allocable amount of a covered purchase is treated as made first from covered fundings.

(7) *Rules for allocating covered fundings to allocable amounts of covered purchases*—(i) *In general.* The rules of this paragraph (e)(7) apply for purposes of determining the extent to which a covered purchase is treated as funded by covered fundings. For purposes of applying this paragraph (e)(7), a reference to covered fundings means all covered fundings by all applicable specified affiliates with respect to an applicable foreign corporation, and a covered funding denominated in a currency other than the U.S. dollar is converted into U.S. dollars at the spot rate (as defined in § 1.988–1(d)(1) of this chapter) on the date of the funding. To the extent covered fundings are allocated to an allocable amount of a covered purchase under this paragraph (e)(7), those fundings are not allocated to any other allocable amounts of covered purchases.

(ii) *Multiple covered purchases.* If there are multiple covered purchases by one or more relevant entities or an applicable foreign corporation, then covered fundings are allocated to the allocable amounts of covered purchases in the order in which the covered purchases occur. If multiple covered purchases occur simultaneously, covered fundings are allocated to the allocable amounts of those simultaneous covered purchases on a pro rata basis, based on the relative allocable amounts of those covered purchases.

(iii) *Single covered funding.* If there is a single covered funding, the covered funding is allocated to a covered purchase to the extent of the lesser of the amount of the covered funding or the allocable amount of the covered purchase.

(iv) *Multiple covered fundings.* If there are multiple covered fundings and the aggregate amount of those fundings exceeds the allocable amount of the covered purchase, then covered fundings are allocated to the allocable amount of the covered purchase in the order in which the covered fundings occur. If multiple covered fundings occur simultaneously, those covered fundings are allocated to the allocable amount of the covered purchase on a pro rata basis, based on the relative amounts of those covered fundings. To the extent the aggregate amount of covered fundings exceeds the allocable amount of the covered purchase, those excess covered fundings are allocated to

the allocable amounts of other covered purchases, if any.

(f) *Status as applicable foreign corporation or covered surrogate foreign corporation*—(1) *Initiation date.* A corporation becomes an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, at the beginning of the corporation's initiation date.

(2) *Cessation date*—(i) *In general.* Except as provided in paragraph (f)(2)(ii) of this section, a corporation ceases to be an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, at the end of the corporation's cessation date.

(ii) *Repurchases after cessation date.* If an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, ceases to be an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, pursuant to a plan that includes a repurchase, and if the cessation date precedes the date on which any section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, undertaken pursuant to the plan occurs (for example, if stock of an applicable foreign corporation ceases trading prior to completion of an acquisitive reorganization), then the corporation will continue to be an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, with regard to each repurchase pursuant to the plan until the end of the date on which the last section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, pursuant to the plan occurs.

(3) *Inbound and outbound F reorganizations*—(i) *Inbound F reorganization.* In the case of a foreign corporation that transfers its assets or that is treated as transferring its assets to a domestic corporation in an F reorganization (as described in § 1.367(b)–2(f) of this chapter), the corporation is not treated as a domestic corporation until the day after the reorganization.

(ii) *Outbound F reorganization.* In the case of a domestic corporation that transfers its assets or that is treated as transferring its assets to a foreign corporation in an F reorganization (as described in § 1.367(a)–1(e) of this chapter), the corporation is not treated as a foreign corporation until the day after the reorganization.

(g) *Status as applicable specified affiliate, a relevant entity of an applicable foreign corporation, or a specified affiliate of a covered surrogate foreign corporation*—(1) *Timing of determination.* The determination of whether a corporation or partnership is an applicable specified affiliate or a relevant entity of an applicable foreign corporation or a specified affiliate of a covered surrogate foreign corporation, as applicable, is made whenever such determination is relevant for purposes of this section.

(2) *Determination of indirect ownership.* Except as provided in paragraph (h)(2)(ii)(B) of this section, a corporation or partnership is treated as indirectly owning stock in a corporation or holding capital or profits interests in a partnership equal to the corporation's or partnership's proportionate percentage of stock owned or capital or profits interests held through other entities.

(3) *Consequences of becoming a specified affiliate*—(i) *General rule.* Except as provided in paragraph (g)(3)(ii) of this section, if a corporation or partnership becomes a specified affiliate of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, and, at the time the corporation or partnership becomes a specified affiliate, the corporation or partnership owns stock of the applicable foreign corporation or covered surrogate foreign corporation that the corporation or partnership acquired after December 31, 2022, and such stock represents more than one percent of the fair market value of the assets of the corporation or partnership as determined at the time that the corporation or partnership becomes a specified affiliate, then for purposes of this section, such stock is treated as acquired by the corporation or partnership immediately after the corporation or partnership becomes a specified affiliate.

(ii) *Stock previously treated as acquired not subject to deemed acquisition more than once.* Paragraph (g)(3)(i) of this section does not apply with regard to any shares of stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable—

(A) Held by the corporation or partnership described in paragraph (g)(3)(i) of this section at the time that it becomes a specified affiliate; and

(B) That the section 4501(d) covered corporation identifies as previously having been subject to paragraph (g)(3)(i) of this section when held by the corporation or partnership.

(iii) *Specific identification.* For purposes of paragraphs (g)(3)(i) and (g)(3)(ii)(B) of this section, if the section 4501(d) covered corporation is unable to specifically identify which shares of stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, the corporation or partnership described in paragraph (g)(3)(i) is treated as holding at the time it becomes a specified affiliate, the section 4501(d) covered corporation must treat the corporation or partnership described in paragraph (g)(3)(i) of this section as holding the most recently acquired shares of the stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable.

(h) *Foreign partnerships that are applicable specified affiliates*—(1) *In general.* A foreign partnership is an applicable specified affiliate of an applicable foreign corporation, if—

(i) More than 50 percent of the capital interests or profits interests of the foreign partnership are held, directly or indirectly, by the applicable foreign corporation; and

(ii) Under the rules described in paragraphs (h)(2) through (5) of this section, at least one domestic entity is a direct or indirect partner with respect to the foreign partnership.

(2) *Direct or indirect partner.* Except as provided in paragraphs (h)(4) and (5) of this section—

(i) A domestic entity is a direct partner with respect to a foreign partnership if it directly owns an interest in the foreign partnership; and

(ii) A domestic entity is an indirect partner with respect to a foreign partnership if the domestic entity owns an interest in the foreign partnership indirectly through—

(A) One or more other foreign partnerships;

(B) One or more foreign corporations controlled by one or more domestic entities within the meaning of paragraph (h)(3) of this section; or

(C) An ownership chain with one or more entities described in paragraphs (h)(2)(ii)(A) and (B) of this section.

(3) *Control of a foreign corporation.* For purposes of paragraph (h)(2)(ii)(B) of this section, a foreign corporation is controlled by one or more domestic entities, if more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote or the total value of the stock of such corporation is owned, directly or indirectly, in aggregate, by one or more domestic entities.

(4) *Indirect interests held through applicable foreign corporations.* Solely for purposes of paragraph (h)(2)(ii) of this section, if an applicable foreign corporation owns, directly or indirectly, stock of a foreign corporation or an interest in a foreign partnership, a domestic entity is not treated as indirectly owning stock of the foreign corporation or an interest in the foreign

partnership solely by reason of owning, directly or indirectly, stock of the applicable foreign corporation.

(5) *De minimis domestic entity (direct or indirect) partner.* A foreign partnership that has one or more domestic entities as direct or indirect partners is not considered an applicable specified affiliate if the domestic entities hold, directly or indirectly, in aggregate, less than five percent of the capital interests and profits interests in the foreign partnership.

(i) [Reserved]

(j) *AFC repurchase or CSFC repurchase*—(1) *Overview.* This paragraph (j) provides rules for determining whether a transaction is an AFC repurchase or CSFC repurchase for purposes of this section. Paragraph (j)(2) of this section provides a general rule regarding the scope of such terms. Paragraph (j)(3) of this section provides an exclusive list of transactions that are treated as a section 317(b) redemption but are not AFC repurchases or CSFC repurchases. Paragraph (j)(4) of this section provides an exclusive list of transactions that are section 4501(d) economically similar transactions. Paragraph (j)(5) of this section provides a non-exclusive list of transactions that are not AFC repurchases or CSFC repurchases.

(2) *Scope of AFC repurchases and CSFC repurchases.* For purposes of this section, an *AFC repurchase* or *CSFC repurchase* means solely—

(i) A section 317(b) redemption with respect to stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, except as provided in paragraph (j)(3) of this section; or

(ii) A section 4501(d) economically similar transaction described in paragraph (j)(4) of this section.

(3) *Certain section 317(b) redemptions not AFC repurchases or CSFC repurchases.* This paragraph (j)(3) provides an exclusive list of transactions that are section 317(b) redemptions but are not AFC repurchases or CSFC repurchases.

(i) *Section 304(a)(1) transactions*—(A) *Rule regarding deemed distributions.* If section 304(a)(1) applies to an acquisition of stock by an acquiring corporation (within the meaning of section 304(a)(1)), the acquiring corporation's deemed distribution in redemption of the acquiring corporation's stock (resulting from the application of section 304(a)(1)) is not an AFC repurchase or CSFC repurchase, as applicable.

(B) *Scope of rule.* The rule described in paragraph (j)(3)(i)(A) of this section applies to a transaction described in paragraph (j)(3)(i)(A) of this section regardless of whether section 302(a) or (d) of the Code applies to the acquiring corporation's deemed distribution in redemption of its stock.

(ii) *Payment by an applicable foreign corporation or a covered surrogate foreign corporation of cash in lieu of fractional shares.* A payment by an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, of cash in lieu of a fractional share of the applicable foreign corporation or covered surrogate foreign corporation is not an AFC repurchase or CSFC repurchase, as applicable, if—

(A) The payment is carried out as part of a transaction that qualifies as a reorganization under section 368(a) or a distribution to which section 355 of the Code applies, or pursuant to the settlement of an option or similar financial instrument (for example, a convertible debt instrument or convertible preferred share);

(B) The cash received by the shareholder entitled to the fractional share is not separately bargained-for consideration (that is, the cash paid by the applicable foreign corporation or covered surrogate foreign corporation in lieu of the fractional share represents a mere rounding off of the shares issued in the exchange or settlement);

(C) The payment is carried out solely for administrative convenience (and, therefore, solely for non-tax reasons); and

(D) The amount of cash paid to the shareholder in lieu of a fractional share does not exceed the fair market value of one full share of the class of stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, with respect to which the payment of cash in lieu of a fractional share is made.

(4) *Section 4501(d) economically similar transactions.* This paragraph (j)(4) provides an exclusive list of transactions that are economically similar transactions for section 4501(d) purposes (each a *section 4501(d) economically similar transaction*).

(i) *Acquisitive reorganizations.* In the case of an acquisitive reorganization in which the target corporation is an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, the exchange by the target corporation shareholders of their target corporation stock pursuant to the plan of reorganization is an AFC repurchase or a CSFC repurchase, as applicable, by the target corporation.

(ii) *E Reorganizations.* In the case of an E reorganization in which the recapitalizing corporation is an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, the exchange by the recapitalizing corporation shareholders of their recapitalizing corporation stock pursuant to the plan of reorganization is an AFC repurchase or a CSFC repurchase, as applicable, by the recapitalizing corporation.

(iii) *F Reorganizations.* In the case of an F reorganization in which the transferor corporation (as defined in § 1.368–2(m)(1) of this chapter) is an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, the exchange by the transferor corporation shareholders of their transferor corporation stock pursuant to the plan of reorganization is an AFC repurchase or a CSFC repurchase, as applicable, by the transferor corporation.

(iv) *Split-offs.* In the case of a split-off by a distributing corporation that is an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, the exchange by the distributing corporation shareholders of their distributing corporation stock is an AFC repurchase or a CSFC repurchase, as applicable, by the distributing corporation.

(v) *Complete liquidations to which both sections 331 and 332 apply.* In the case of a complete liquidation of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, to which sections 331 and 332(a) of the Code respectively apply to component distributions of the complete liquidation—

(A) Each distribution to which section 331 applies is an AFC repurchase or a CSFC repurchase, as applicable; and

(B) The distribution to which section 332(a) applies is not an AFC repurchase or a CSFC repurchase, as applicable. *See* paragraph (j)(5)(i)(A) of this section.

(vi) *Certain forfeitures and clawbacks of stock*—(A) *In general.* In the case of a forfeiture or clawback of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, pursuant to a legal or contractual obligation, the forfeiture or clawback is an AFC repurchase or a CSFC repurchase, as applicable, on the date of forfeiture or clawback (as appropriate) if the stock was treated as issued or provided under paragraph (n)(1) of this section and the forfeiture or clawback of the stock (as appropriate) is described in paragraph (j)(4)(vi)(B), (C), or (D) of this section.

(B) *Stock subject to post-closing price adjustments.* The stock was issued pursuant to an acquisition of a target entity or its business, and the forfeiture of the stock was in accordance with the terms of the documents governing the

transaction (for example, to compensate the acquiring corporation for breaches of representations or warranties made by the target entity, or because the business of the target entity did not achieve certain performance benchmarks agreed upon in the transaction documents).

(C) *Stock for which a section 83(b) election was made.* The stock was subject to a substantial risk of forfeiture within the meaning of section 83(a) of the Code on the date the stock was issued or provided, the service provider made a valid election under section 83(b) with regard to the stock, and the forfeiture resulted from the service provider failing to meet the vesting condition.

(D) *Clawbacks.* On the date the stock was issued or provided, the stock was subject to a clawback agreement, and a clawback of the stock resulted from the occurrence of an event specified in the clawback agreement.

(5) *Transactions that are not AFC repurchases or CSFC repurchases.* This paragraph (j)(5) provides a non-exclusive list of transactions that are not AFC repurchases or CSFC repurchases.

(i) *Complete liquidations generally.* Except as provided in paragraph (j)(4)(v)(A) of this section, the following is not an AFC repurchase or CSFC repurchase, as applicable:

(A) A distribution in complete liquidation of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, to which section 331 or 332(a) applies.

(B) A distribution pursuant to a plan of dissolution of such corporation that is reported on the original (but not a supplemented or an amended) IRS Form 966, *Corporate Dissolution or Liquidation* (or any successor form).

(C) A distribution pursuant to a deemed dissolution of such corporation (for instance, a deemed liquidation under § 301.7701–3 of this chapter).

(ii) *Distributions during taxable year of complete liquidation or dissolution.* Unless paragraph (j)(4)(v) of this section applies, no distribution by an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, during such corporation's taxable year is an AFC repurchase or CSFC repurchase, as applicable, if the applicable foreign corporation or covered surrogate foreign corporation—

(A) Completely liquidates during such corporation's taxable year (that is, has a final distribution during the taxable year in a complete liquidation to which section 331 applies);

(B) Dissolves during the taxable year pursuant to a plan of dissolution as reported on the original (but not a supplemented or an amended) IRS Form 966, *Corporate Dissolution or Liquidation* (or any successor form); or

(C) Is deemed to dissolve during the taxable year (for instance, pursuant to a deemed liquidation under § 301.7701–3 of this chapter).

(iii) *Divisive transactions under section 355 other than split-offs*—(A) *In general.* Subject to paragraph (j)(5)(iii)(B) of this section, a distribution by a distributing corporation that is an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, of stock of a controlled corporation qualifying under section 355 that is not a split-off is not an AFC repurchase or CSFC repurchase, as applicable.

(B) *Exception regarding non-qualifying property in spin-offs.* A distribution by a distributing corporation that is an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, of other property or money in exchange for stock of the distributing corporation is a repurchase by the distributing corporation if it occurs in pursuance of a transaction qualifying under section 355 in which the distribution by the distributing corporation of stock of the controlled corporation is with respect to stock of the distributing corporation.

(iv) *Non-redemptive distributions subject to section 301(c)(2) or (3).* A distribution to which section 301 of the Code applies by an applicable foreign corporation or a covered surrogate foreign corporation to a distributee is not an AFC repurchase or CSFC repurchase if the distribution—

(A) Is subject to section 301(c)(2) or (3); and

(B) The distributee does not exchange stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable (and is not treated as exchanging stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, for Federal income tax purposes).

(v) *Net cash settlement of an option contract.* The net cash settlement of an option contract with respect to stock of an applicable foreign corporation or a covered surrogate foreign corporation is not an AFC repurchase or CSFC repurchase, as applicable. The net cash settlement of an instrument in the legal form of an option contract or other derivative financial instrument that is treated as stock for Federal tax purposes at the time of issuance is treated as a repurchase of that instrument, and therefore an AFC repurchase or CSFC repurchase, as applicable.

(k) *Date of section 4501(d)(1) repurchase or section 4501(d)(2) repurchase*—(1) *General rule.* In general, stock of an applicable foreign corporation or a covered surrogate foreign corporation is treated as subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, on the date on which ownership of the stock transfers to the specified affiliate of the applicable foreign corporation, the applicable foreign corporation, the specified affiliate of the covered surrogate foreign corporation, or the covered surrogate foreign corporation, as applicable, for Federal income tax purposes. To determine the date of repurchase in particular situations, *see* paragraphs (k)(2), (3), and (4) of this section.

(2) *Regular-way sale.* A regular-way sale of stock of an applicable foreign corporation or a covered surrogate foreign corporation (that is, a transaction in which a trade order is placed on the trade date, and settlement of the transaction, including payment and delivery of the stock, occurs a standardized number of days after the trade date that is set by a regulator) is treated as subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, on the trade date.

(3) *AFC repurchase or CSFC repurchase pursuant to certain section 4501(d) economically similar transactions.* Stock of an applicable foreign corporation or a covered surrogate foreign corporation repurchased in an AFC repurchase or a CSFC repurchase that is a section 4501(d) economically similar transaction described in paragraph (j)(4) of this section is treated as repurchased on the date the shareholders of the applicable foreign corporation or covered surrogate foreign corporation exchange their stock in such corporation.

(4) *Section 4501(d)(1) repurchase pursuant to a covered funding.* To the extent an applicable specified affiliate of an applicable foreign corporation is treated under paragraph (e) of this section as acquiring stock of the applicable foreign corporation that is repurchased or acquired in a covered purchase, such stock is treated as acquired by the applicable specified affiliate on the date of the covered purchase. However, if the date of the covered funding occurs after the date of the covered purchase, then such stock is treated as acquired by the applicable specified affiliate on the date of the covered funding.

(l) *Fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation that is repurchased or acquired*—(1) *In*

general. The fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase is the market price of the stock on the date of the section 4501(d)(1) repurchase or section 4501(d)(2) repurchase (as determined under paragraph (k) of this section without regard to the last sentence of paragraph (k)(4) of this section). That is, if the price at which the repurchased or acquired stock is purchased differs from the market price of the stock on the date the stock is repurchased or acquired, the fair market value of the stock is the market price on the date the stock is repurchased or acquired.

(2) *Stock traded on an established securities market*—(i) *In general.* If stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase with respect to a section 4501(d) covered corporation is traded on an established securities market, the section 4501(d) covered corporation must determine the market price of the stock by applying one of the methods provided in paragraph (l)(2)(ii) of this section. For purposes of this paragraph (l)(2), stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, is treated as traded on an established securities market if any stock of the same class and issue of stock is so traded, regardless of whether the shares repurchased or acquired are so traded.

(ii) *Acceptable methods.* The following are acceptable methods for determining the market price of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, traded on an established securities market:

(A) The daily volume-weighted average price as determined on the date the stock is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase.

(B) The closing price on the date the stock is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase.

(C) The average of the high and low prices on the date the stock is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase.

(D) The trading price at the time the stock is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase.

(iii) *Date of section 4501(d)(1) repurchase or section 4501(d)(2) repurchase not a trading day.* For purposes of each method provided in paragraph (l)(2)(ii) of this section, if the date stock is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase is not a trading day, the date on which the market price is determined is the immediately preceding trading day.

(iv) *Consistency requirement.* The market price of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is traded on an established securities market must be determined by consistently applying one (but not more than one) of the methods provided in paragraph (l)(2)(ii) of this section to all section 4501(d)(1) repurchases with respect to an applicable foreign corporation or all section 4501(d)(2) repurchases with respect to a covered surrogate foreign corporation, as applicable, in the same taxable year of the applicable foreign corporation or covered surrogate foreign corporation, as applicable (which, if the applicable foreign corporation or covered surrogate foreign corporation, as applicable, does not have a taxable year for Federal income tax purposes, is the calendar year).

(v) *Stock traded on multiple exchanges*—(A) *In general.* A section 4501(d) covered corporation must determine the fair market value of the stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, by reference to trading on the established securities market in the country in which the applicable foreign corporation or covered surrogate foreign corporation, as applicable, is organized, including a regional established securities market that trades in that country.

(B) *Stock traded on multiple exchanges in country where corporation is organized.* If the stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, is traded on multiple established securities markets in the country in which the applicable foreign corporation or covered surrogate foreign corporation, as applicable, is organized, a section 4501(d) covered corporation must treat the established securities market with the highest trading volume in the stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, in the section 4501(d) covered corporation's prior taxable year as the established securities market that the section 4501(d) covered corporation must reference to determine the fair market value of the stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable.

(C) *Other cases in which stock is traded on multiple exchanges.* If stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable is traded on multiple established securities markets and paragraphs (l)(2)(v)(A) and (B) of this section do not apply, a section 4501(d) covered corporation must determine the fair market value of the stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, in a manner that is reasonable under the facts and circumstances.

(3) *Stock not traded on an established securities market*—(i) *General rule.* If stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, is not traded on an established securities market, the market price of the stock is determined as of the date of the section 4501(d)(1) repurchase or section 4501(d)(2) repurchase under the principles of § 1.409A–1(b)(5)(iv)(B)(*1*) of this chapter.

(ii) *Consistency requirement.* The valuation method for determining the market price of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is not traded on an established securities market must be used for all section 4501(d)(1) repurchases with respect to the same class of stock of an applicable foreign corporation or all section 4501(d)(2) repurchases with respect to the same class of stock of a covered surrogate foreign corporation, as applicable, in the same taxable year of the applicable foreign corporation or covered surrogate foreign corporation, as applicable (which, if the applicable foreign corporation or covered surrogate foreign corporation, as applicable, does not have a taxable year for Federal income tax purposes, is the calendar year), unless the application of that method to a particular section 4501(d)(1) repurchase or section 4501(d)(2) repurchase would be unreasonable under the facts and circumstances as of the valuation date within the meaning of § 1.409A–1(b)(5)(iv)(B)(*1*) of this chapter.

(4) *Market price of stock denominated in non-U.S. currency.* The market price of any stock of an applicable foreign corporation or a covered surrogate foreign corporation that is denominated in a currency other than the U.S. dollar is converted into U.S. dollars at the spot rate (as defined in § 1.988–1(d)(1) of this chapter) on the date the stock is subject to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase.

(m) *Section 4501(d) statutory exceptions*—(1) *In general*—(i) *Overview.* This paragraph (m) provides rules regarding the application of the exceptions in section 4501(e) (each, a *section 4501(d) statutory exception*), other than the section 4501(d) de minimis exception, to a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase.

(ii) *Reduction of section 4501(d) excise tax base.* The fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, repurchased or acquired in a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase described in this paragraph (m) is a reduction for purposes of computing the section 4501(d) covered corporation's section 4501(d) excise tax base. *See* paragraph (c)(3)(i)(B) of this section.

(2) *Section 4501(d) reorganization exception.* The fair market value of stock repurchased in an AFC repurchase that is a section 4501(d)(1) repurchase or a CSFC repurchase that is a section 4501(d)(2) repurchase described in any of paragraphs (m)(2)(i) through (iv) of this section is a reduction for purposes of computing the section 4501(d) covered corporation's section 4501(d) excise tax base (*section 4501(d) reorganization exception*) to the extent that such AFC repurchase or CSFC repurchase is for property permitted by section 354 or 355 of the Code to be received without the recognition of gain or loss:

(i) A repurchase by a target corporation in an acquisitive reorganization pursuant to the plan of reorganization.

(ii) A repurchase by a recapitalizing corporation in an E reorganization pursuant to the plan of reorganization.

(iii) A repurchase by a transferor corporation in an F reorganization pursuant to the plan of reorganization.

(iv) A repurchase by a distributing corporation in a split-off (whether or not part of a D reorganization).

(3) *Stock contributions to an employer-sponsored retirement plan*—(i) *Reductions to section 4501(d) excise tax base*—(A) *General rule.* The fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is repurchased or acquired in a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, with respect to a section 4501(d) covered corporation, is a reduction for purposes of computing the section 4501(d) covered corporation's section 4501(d) excise tax base if the stock that is repurchased or acquired, or an amount of stock equal to the fair market value of the stock repurchased or acquired, is contributed to an employer-sponsored retirement plan.

(B) *Special rule for leveraged ESOPs.* If a section 4501(d) covered corporation maintains an ESOP with an exempt loan (as defined in section 4975(d)(3) of the Code), allocations of qualifying employer securities that are stock of the applicable foreign corporation or covered surrogate foreign corporation from the ESOP suspense account to ESOP participants' accounts that are attributable to employer contributions (and not to dividends) are treated as contributions of stock under this paragraph (m)(3), as of the date stock attributable to repayment of the exempt loan is released from the suspense account and allocated to ESOP participants' accounts.

(ii) *Classes of stock contributed to an employer-sponsored retirement plan.* This paragraph (m)(3) applies to contributions of any class of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, to an employer-sponsored retirement plan regardless of the class of stock that was repurchased or acquired in a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase by the section 4501(d) covered corporation.

(iii) *Determining amount of reduction to section 4501(d) excise tax base.* The amount of the reduction under paragraph (m)(3)(i) of this section for a section 4501(d) covered corporation is determined as provided in paragraph (m)(3)(iii)(A) or (B) of this section.

(A) *Same class of stock repurchased and contributed.* If stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, is repurchased or acquired in a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, with respect to a section 4501(d) covered corporation, and stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, that is of the same class is contributed to an employer-sponsored retirement plan of the section 4501(d) covered corporation, the amount of the reduction under paragraph (m)(3)(i) of this section is equal to the lesser of—

(*1*) The aggregate fair market value of the stock of the same class that was repurchased or acquired (as determined under paragraph (l) of this section) during the taxable year; or

(*2*) The amount obtained by—

(*i*) Determining the aggregate fair market value of all stock of that class repurchased or acquired in all section 4501(d)(1) repurchases or section 4501(d)(2) repurchases, as applicable, with respect to the section 4501(d) covered corporation (as determined under paragraph (l) of this section) during its taxable year, reduced by the fair market value of shares of that class of stock that is a reduction to the section 4501(d) excise tax base for the taxable year under a section 4501(d) statutory exception other than this paragraph (m)(3);

(*ii*) Dividing the amount determined under paragraph (m)(3)(iii)(A)(*2*)(*i*) of this section by the number of shares of that class repurchased or acquired in all section 4501(d)(1) repurchases or section 4501(d)(2) repurchases, as applicable, with respect to the section 4501(d) covered corporation during the taxable year, reduced by the number of shares of that class of stock the fair market value of which is a reduction to the section 4501(d) excise tax base for the taxable year under a section 4501(d) statutory exception other than this paragraph (m)(3); and

(*iii*) Multiplying the amount determined under paragraph (m)(3)(iii)(A)(*2*)(*ii*) of this section by the number of shares of that class contributed to an employer-sponsored retirement plan for the taxable year.

(B) *Different class of stock repurchased and contributed*—(*1*) *In general.* If stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, of a different class of stock than is repurchased or acquired in a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, with respect to a section 4501(d) covered corporation is contributed to an employer-sponsored retirement plan of the section 4501(d) covered corporation, then the amount of the reduction under paragraph (m)(3)(i) of this section is equal to the fair market value of the contributed stock at the time the stock is contributed to the employer-sponsored retirement plan.

(*2*) *Maximum reduction permitted.* The amount of the reduction under paragraph (m)(3)(i) of this section must not exceed the section 4501(d) excise tax base for the taxable year (determined without regard to any reduction under paragraph (m)(3)(i) of this section), reduced by the fair market value of any stock that is a reduction to the section 4501(d) excise tax base for the taxable year under a section 4501(d) statutory exception other than this paragraph (m)(3).

(iv) *Timing of contributions*—(A) *In general.* The reduction in the section 4501(d) excise tax base, in accordance with paragraph (m)(3)(i) of this section

(that is, the reduction in the section 4501(d) excise tax base), for a taxable year applies to contributions of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, to an employer-sponsored retirement plan during the section 4501(d) covered corporation's taxable year.

(B) *Treatment of contributions after close of taxable year.* For purposes of paragraph (m)(3)(i) of this section, a section 4501(d) covered corporation may treat stock contributions to an employer-sponsored retirement plan made after the close of the section 4501(d) covered corporation's taxable year as having been contributed during that taxable year if the following two requirements are satisfied:

(*1*) The stock must be contributed to the employer-sponsored retirement plan by the filing deadline for the form on which the section 4501(d) excise tax must be reported (applicable form) that is due for the first full quarter after the close of the section 4501(d) covered corporation's taxable year.

(*2*) The stock must be treated by the employer-sponsored retirement plan in the same manner that the plan would treat a contribution received on the last day of that taxable year.

(C) *No duplicate reductions.* Stock contributions that are treated under paragraph (m)(3)(iv)(B) of this section as having been contributed in the taxable year to which the applicable form applies may not be treated as having been contributed for any other taxable year for purposes of the section 4501(d) excise tax.

(v) *Contributions before January 1, 2023.* A section 4501(d) covered corporation with a taxable year that both begins before January 1, 2023, and ends after December 31, 2022, may include the fair market value of all contributions of its stock to an employer-sponsored retirement plan during the entirety of that taxable year for purposes of applying this paragraph (m)(3).

(4) *Repurchases or acquisitions by a dealer in securities in the ordinary course of business*—(i) *In general.* Subject to paragraph (m)(4)(ii) of this section, the fair market value of stock repurchased or acquired in a section 4501(d)(1) repurchase (for this purpose, determined without regard to paragraph (b)(2)(xxii)(B) of this section) or a covered purchase that is treated as a section 4501(d)(1) repurchase by a specified affiliate of an applicable foreign corporation or an applicable foreign corporation, or in a section 4501(d)(2) repurchase by a specified affiliate of a covered surrogate foreign corporation or a covered surrogate foreign corporation, is a reduction for purposes of computing the section 4501(d) covered corporation's section 4501(d) excise tax base if the repurchasing or acquiring entity is a dealer in securities (within the meaning of section 475(c)(1) of the Code) to the extent the stock is repurchased or acquired in the ordinary course of the dealer's business of dealing in securities.

(ii) *Applicability.* The reduction described in paragraph (m)(4)(i) of this section applies solely to the extent that—

(A) The dealer accounts for the stock as securities held primarily for sale to customers in the dealer's ordinary course of business;

(B) The dealer disposes of the stock within a period of time that is consistent with the holding of the stock for sale to customers in the dealer's ordinary course of business, taking into account the terms of the stock and the conditions and practices prevailing in the markets for similar stock during the period in which the stock is held; and

(C) The dealer (if it is an applicable foreign corporation or a covered surrogate foreign corporation) does not sell or otherwise transfer the stock to a specified affiliate of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, or the dealer (if it is a specified affiliate of an applicable foreign corporation or of a covered surrogate foreign corporation, as applicable) does not sell or otherwise transfer the stock to the applicable foreign corporation, covered surrogate foreign corporation, or to another specified affiliate of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, in each case other than in a sale or transfer to a dealer that also satisfies the requirements of this paragraph (m)(4)(ii).

(5) *Repurchases by a RIC or REIT.* Section 4501(e)(5) does not apply for purposes of section 4501(d).

(6) *AFC repurchase or CSFC repurchase treated as a dividend*—(i) *In general.* In accordance with paragraph (m)(6)(ii) of this section, the fair market value of stock repurchased by an applicable foreign corporation or a covered surrogate foreign corporation in an AFC repurchase or a CSFC repurchase, as applicable, is a reduction for purposes of computing the section 4501(d) covered corporation's section 4501(d) excise tax base to the extent the AFC repurchase or CSFC repurchase, as applicable, is treated as a distribution of a dividend under section 301(c)(1) or 356(a)(2).

(ii) *Rebuttable presumption of no dividend equivalence.* An AFC repurchase or CSFC repurchase to which section 302 or 356(a) applies is presumed to be subject to section 302(a) or 356(a)(1), respectively (and, therefore, is presumed ineligible for the exception in paragraph (m)(6)(i) of this section). A section 4501(d) covered corporation may rebut this presumption with regard to a specific shareholder of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, solely by establishing with sufficient evidence that the shareholder treats the AFC repurchase or CSFC repurchase as a dividend on the shareholder's Federal income tax return or, for a shareholder who does not have a Federal income tax filing obligation with respect to the AFC repurchase or CSFC repurchase, would properly treat the AFC repurchase or CSFC repurchase as a dividend if the shareholder filed a Federal income tax return.

(n) *Application of section 4501(d) netting rule*—(1) *In general.* This paragraph (n) provides the *section 4501(d) netting rule,* under which the section 4501(d) excise tax base with respect to a section 4501(d) covered corporation for a taxable year is reduced only by stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, issued or provided by the section 4501(d) covered corporation to its employees during its taxable year. Any reference in this paragraph (n) to issuing or providing stock to an employee refers solely to stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, that is issued or provided by a section 4501(d) covered corporation to an employee in connection with the employee's performance of services in the employee's capacity as an employee of the section 4501(d) covered corporation. The fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, that is described in this paragraph (n) is a reduction for purposes of computing the section 4501(d) covered corporation's section 4501(d) excise tax base. *See* paragraph (c)(3)(i)(C) of this section.

(2) *Stock issued or provided outside period of applicable foreign corporation or covered surrogate foreign corporation status.* Any stock issued or provided prior to the initiation date or after the cessation date of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, is not taken into account under paragraph (n)(1) of

this section. *See* paragraph (f)(1) of this section.

(3) *Issuances or provisions before January 1, 2023.* Except as provided in paragraph (n)(2) of this section, a section 4501(d) covered corporation with a taxable year that begins before January 1, 2023, and ends after December 31, 2022, must include the fair market value of issuances or provisions of stock that occur before January 1, 2023, in such taxable year for purposes of paragraph (n)(1) of this section for that taxable year.

(4) *F reorganizations.* For purposes of this paragraph (n), the transferor corporation and the resulting corporation (as defined in § 1.368–2(m)(1) of this chapter) in an F reorganization are treated as the same corporation.

(5) *Stock issued or provided in connection with the performance of services*—(i) *In general.* For purposes of this paragraph (n), stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, is transferred by the section 4501(d) covered corporation in connection with the performance of services only if the transfer is described in section 83, including pursuant to a nonqualified stock option described in § 1.83–7 of this chapter, or is pursuant to a stock option described in section 421 of the Code.

(ii) *Sale of shares to cover exercise price or withholding*—(A) *Payment or advance by third party equal to exercise price.* If a third party pays the exercise price of a stock option on behalf of an employee or advances to an employee an amount equal to the exercise price of a stock option that the employee uses to exercise the option, then any stock transferred by the section 4501(d) covered corporation to the employee or to the third party in connection with exercising the option is treated as issued or provided in connection with the performance of the services.

(B) *Advance by third party equal to withholding obligation.* If a third party advances an amount equal to the withholding obligation of an employee, then any stock transferred by the section 4501(d) covered corporation to the employee or to the third party in connection with this arrangement is treated as issued or provided in connection with the performance of services.

(6) *Date of issuance or provision for section 4501(d) netting rule*—(i) *In general.* Stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, is issued or provided to an employee of a section 4501(d) covered corporation as of the date the employee is treated as the beneficial owner of the stock for Federal income tax purposes. In general, an employee is treated as the beneficial owner of the stock when the stock is both transferred by the section 4501(d) covered corporation and substantially vested within the meaning of § 1.83–3(b) of this chapter. Thus, stock transferred pursuant to a vested stock award or restricted stock unit is issued or provided when the section 4501(d) covered corporation initiates payment of the stock. Stock transferred that is not substantially vested within the meaning of § 1.83–3(b) of this chapter is not issued or provided until it vests, except as provided in paragraph (n)(6)(iii) of this section.

(ii) *Stock options and stock appreciation rights.* Stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, transferred by a section 4501(d) covered corporation pursuant to an option described in § 1.83–7 of this chapter or section 421 or a stock appreciation right is issued or provided by the section 4501(d) covered corporation as of the date the option or stock appreciation right is exercised.

(iii) *Stock on which a section 83(b) election is made.* Stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, transferred by the section 4501(d) covered corporation when it is not substantially vested within the meaning of § 1.83–3(b) of this chapter, but as to which a valid election under section 83(b) is made, is treated as issued or provided by the section 4501(d) covered corporation as of the transfer date.

(7) *Fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation that is issued or provided to employees*—(i) *In general.* For purposes of paragraph (n)(1) of this section, the fair market value of stock of an applicable foreign corporation or a covered surrogate foreign corporation that is issued or provided is determined under section 83 as of the date the stock is issued or provided to an employee by the section 4501(d) covered corporation. The fair market value of the stock is determined under the rules provided in section 83 regardless of whether an amount is includible in the employee's income under section 83 or otherwise. For example, the fair market value of stock issued or provided by a section 4501(d) covered corporation to its employee pursuant to a stock option described in section 421 and stock issued or provided by a section 4501(d) covered corporation to an employee who is a nonresident alien for services performed outside of the United States is determined using the rules provided in section 83.

(ii) *Market price of stock denominated in non-U.S. currency.* The market price of any stock of an applicable foreign corporation or a covered surrogate foreign corporation that is denominated in a currency other than the U.S. dollar is converted into U.S. dollars at the spot rate (as defined in § 1.988–1(d)(1) of this chapter) on the date the stock is issued or provided by the section 4501(d) covered corporation to its employee.

(8) *Issuances that are disregarded for purposes of applying the section 4501(d) netting rule*—(i) *In general.* This paragraph (n)(8) lists the sole circumstances in which an issuance or provision of stock by the section 4501(d) covered corporation to its employee is disregarded for purposes of paragraph (n) of this section. The transfers of stock described in § 58.4501–4(f)(1) through (9) are not issuances or provisions of stock by a section 4501(d) covered corporation to its employees and therefore are not relevant to the section 4501(d) netting rule.

(ii) *Stock contributions to an employer-sponsored retirement plan.* Any stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, contributed to an employer-sponsored retirement plan, any stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, treated as contributed to an employer-sponsored retirement plan under paragraph (m)(3) of this section, and any stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, sold to a leveraged or non-leveraged ESOP, is disregarded for purposes of this paragraph (n).

(iii) *Net exercises and share withholding.* Stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, withheld by a section 4501(d) covered corporation to satisfy the exercise price of a stock option issued to an employee, or to pay any withholding obligation, is disregarded for purposes of paragraph (n) of this section. For example, stock of an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, withheld by a section 4501(d) covered corporation to pay the exercise price of a stock option, to satisfy an employer's income tax withholding obligation under section 3402 of the Code, to satisfy an employer's withholding obligation under section 3102 of the Code, or to

satisfy an employer's withholding obligation for State, local, or foreign taxes, is disregarded for purposes of this paragraph (n) to an employee.

(iv) *Settlement other than in stock.* Settlement of an option contract with respect to an applicable foreign corporation or a covered surrogate foreign corporation, as applicable, using any consideration other than stock of the applicable foreign corporation or covered surrogate foreign corporation, as applicable, (including cash) is disregarded for purposes of this paragraph (n).

(v) *Instrument not in the legal form of stock*—(A) *Generally disregarded.* Except as provided in paragraph (n)(8)(v)(B) of this section, the issuance or provision by a section 4501(d) covered corporation of an instrument that is not in the legal form of stock but is treated as stock for Federal income tax purposes (*non-stock instrument*) is disregarded for purposes of the section 4501(d) netting rule.

(B) *Certain instruments treated as issued*—(*1*) *In general.* Subject to paragraphs (n)(8)(v)(B)(2), (3), and (4) of this section, if there is a section 4501(d)(1) repurchase or section 4501(d)(2) repurchase of a non-stock instrument, the issuance or provision of the instrument is regarded for purposes of the section 4501(d) netting rule at the time of such section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, provided that the issuance or provision was by the section 4501(d) covered corporation to its employees. For purposes of the stock repurchase excise tax regulations, the delivery of stock pursuant to the terms of a non-stock instrument is treated as a section 4501(d)(1) repurchase or a section 4501(d)(2) repurchase, as applicable, of the non-stock instrument in exchange for an issuance or provision of the stock that is delivered.

(*2*) *Issuances or provisions before the initiation date or after the cessation date.* Any non-stock instrument issued or provided by the section 4501(d) covered corporation before the initiation date or after the cessation date is not regarded for purposes of the section 4501(d) netting rule.

(*3*) *Identification of an instrument not in the legal form of stock.* The section 4501(d) covered corporation must identify the section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, of a non-stock instrument on the return on which the stock repurchase excise tax must be reported for the section 4501(d) covered corporation's taxable year in which the section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable, occurs (*repurchase year*) in order for the issuance or provision to be regarded under paragraph (n)(8)(v)(B)(*1*) of this section.

(*4*) *Consistency requirement.* In the repurchase year of a non-stock instrument (tested non-stock instrument), the issuance or provision of the non-stock instrument is not regarded under paragraph (n)(8)(v)(B)(*1*) of this section unless the section 4501(d) covered corporation reports or has reported the section 4501(d)(1) repurchase or section 4501(d)(2) repurchase of all other comparable non-stock instruments repurchased or acquired within the five taxable years ending on the last day of the repurchase year in a consistent manner. A comparable non-stock instrument is a non-stock instrument that has substantially similar economic terms as the tested non-stock instrument, regardless of whether the comparable non-stock instrument and the tested non-stock instrument have the same legal form. A comparable non-stock instrument is reported in a consistent manner if it is or was timely reported on the return on which the stock repurchase excise tax must be reported that is or was due for the first full quarter after the close of the repurchase year for such comparable non-stock instrument. Notwithstanding the first sentence of this paragraph (n)(8)(v)(B)(*4*), the issuance or provision of the tested non-stock instrument will be regarded if the section 4501(d) covered corporation demonstrates to the satisfaction of the IRS that the section 4501(d) covered corporation's failure to timely report the repurchase or acquisition of the comparable non-stock instruments was due to reasonable cause (within the meaning § 1.6664–4 of this chapter) and not willful neglect. In determining whether this failure to report was due to reasonable cause and not willful neglect, the IRS will consider all the facts and circumstances, including the steps the section 4501(d) covered corporation took to comply with its Federal tax reporting and payment obligations.

(5) Fair market value of the instrument. The amount of the reduction for purposes of computing the section 4501(d) covered corporation's section 4501(d) excise tax base for a taxable year under this section for the issuance or provision of a non-stock instrument is equal to the lesser of the fair market value of the instrument when the instrument was issued or provided within the meaning of paragraph (n)(7) of this section or the fair market value of the instrument at the time of the section 4501(d)(1) repurchase or section 4501(d)(2) repurchase, as applicable.

(o) *Rules applicable before* April 13, 2024—(1) *Acquisitions of applicable foreign corporation stock.* If an applicable specified affiliate of an applicable foreign corporation acquires stock of the applicable foreign corporation from a person that is not the applicable foreign corporation or another specified affiliate of such applicable foreign corporation—

(i) The applicable specified affiliate is treated as a covered corporation with regard to the acquisition; and

(ii) The acquisition is treated as a repurchase of stock of a covered corporation by a covered corporation.

(2) *Funding rule.* For purposes of applying section 4501(d)(1), an applicable specified affiliate is treated as acquiring stock of an applicable foreign corporation if the applicable specified affiliate funds by any means (including through distributions, debt, or capital contributions) the acquisition or repurchase of stock of the applicable foreign corporation by the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funding is undertaken for a principal purpose of avoiding the stock repurchase excise tax. For purposes of the preceding sentence, the fair market value of stock treated as acquired by the applicable specified affiliate is limited to the amount funded by the applicable specified affiliate. This paragraph (o)(2) applies with respect to a funding that occurs on or after December 27, 2022, provided that the covered purchase occurs after December 31, 2022, and on or before April 12, 2024. *See* paragraph (r)(2) of this section.

(3) *Per se rule.* A principal purpose described in paragraph (o)(2) of this section is deemed to exist if the applicable specified affiliate funds by any means, other than through distributions, the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funded entity acquires or repurchases stock of the applicable foreign corporation within two years of the funding.

(4) *Repurchases or acquisitions of covered surrogate foreign corporation stock.* If a covered surrogate foreign corporation repurchases its stock, or if a specified affiliate of the covered surrogate foreign corporation acquires stock of the covered surrogate foreign corporation—

(i) The expatriated entity with respect to the covered surrogate foreign corporation is treated as a covered

corporation with respect to the repurchase or acquisition; and

(ii) The repurchase or acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation.

(5) *Definitions solely for purposes of paragraph (o)*—(i) *Application of definitions in §§ 58.4501–1(b) and 58.4501–7(b)(2).* Solely for purposes of this paragraph (o), any term used but not defined in this paragraph (o) has the meaning provided in § 58.4501–1(b) or paragraph (b)(2) of this section (other than paragraph (b)(2)(xiii) of this section), as applicable.

(ii) *Definition of applicable specified affiliate.* Solely for purposes of this paragraph (o), the term *applicable specified affiliate* means a specified affiliate of an applicable foreign corporation, other than a foreign corporation or a foreign partnership (unless the partnership has a domestic entity as a direct or indirect partner).

(6) *Early application of rules of this section other than paragraph (o). See* paragraph (r)(3) of this section regarding a section 4501(d) covered corporation's ability to choose to apply all the rules of this section (other than paragraphs (o) and (r)(1) and (2) of this section) to transactions occurring after December 31, 2022.

(p) *Section 4501(d)(1) examples.* The following examples illustrate the application of the rules in this section relating to section 4501(d)(1). For purposes of the following examples, unless otherwise stated: Corporation FZ is an applicable foreign corporation; each entity has a calendar taxable year, has no direct or indirect owner that is a domestic entity, and is not related to any other entity; each corporation's only outstanding stock is a single class of common stock; the functional currency (within the meaning of section 985 of the Code) of any entity is the U.S. dollar; any repurchase or acquisition of the stock of an applicable foreign corporation is from a person who is not the applicable foreign corporation or a specified affiliate of the applicable foreign corporation; no stock is transferred to any employee; for examples that expressly provide that stock is transferred to any employee, such transfer is made in connection with the employee's performance of services in its capacity as an employee of the transferor, and the employee is treated as the beneficial owner of the stock for Federal income tax purposes on the date of the transfer; there are no covered fundings or covered purchases; and the section 4501(d) statutory exceptions are inapplicable.

(1) *Example 1: The section 4501(d) netting rule with respect to a single applicable specified affiliate*—(i) *Facts.* Corporation FZ owns all the outstanding stock of Corporation US1, a domestic corporation. Each of Employee M and Employee P is an employee of Corporation US1. On February 1, 2025, Corporation US1 purchases 100 shares of stock of Corporation FZ when the fair market value of each share is $8x. On May 15, 2025, Corporation US1 transfers to Employee M 50 shares of stock of Corporation FZ when the fair market value of each share is $5x. On November 1, 2025, Corporation US1 transfers to Employee P 30 shares of stock of Corporation US1 when the fair market value of each share is $9x.

(ii) *Analysis.* Corporation US1's purchase of 100 shares of stock of Corporation FZ on February 1, 2025, is a section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xxii)(A) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base for its 2025 taxable year, the fair market value of the 100 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $800x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase increases Corporation US1's section 4501(d) excise tax base for the 2025 taxable year by $800x. 50 shares of Corporation FZ stock are treated as issued or provided to Employee M on May 15, 2025. *See* paragraph (n) of this section. Therefore, Corporation US1's section 4501(d) excise tax base for its 2025 taxable year is reduced by $250x (50 shares x $5x per share = $250x). *See* paragraph (c)(3)(i)(C) of this section. Corporation US1's section 4501(d) excise tax base for its 2025 taxable year is not reduced by the transfer of stock of Corporation US1 to Employee P because the section 4501(d) excise tax base with respect to Corporation US1 can only be reduced by the fair market value of stock of Corporation FZ issued or provided by Corporation US1 to employees of Corporation US1. *See* paragraph (n) of this section. Accordingly, Corporation US1's section 4501(d) excise tax base with respect to these transactions for its 2025 taxable year is $550x ($800x repurchase − $250x issuance = $550x).

(2) *Example 2: The section 4501(d) netting rule with respect to multiple applicable specified affiliates*—(i) *Facts.* Corporation FZ owns all the outstanding stock of both Corporation US1, a domestic corporation, and Corporation US2, a domestic corporation. Employee T is an employee of Corporation US2. On February 1, 2025, Corporation US1 purchases 100 shares of stock of Corporation FZ when the fair market value of each share is $8x. On May 15, 2025, Corporation US2 transfers to Employee T 50 shares of stock of Corporation FZ when the fair market value of each share is $5x.

(ii) *Analysis.* Corporation US1's purchase of 100 shares of stock of Corporation FZ on February 1, 2025, is a section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xxii)(A) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base for its 2025 taxable year, the fair market value of the 100 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $800x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase increases Corporation US1's section 4501(d) excise tax base for the 2025 taxable year by $800x. Corporation US1's section 4501(d) excise tax base for its 2025 taxable year is not reduced by the transfer of stock of Corporation FZ to Employee T, an employee of Corporation US2, because the section 4501(d) excise tax base with respect to Corporation US1 can only be reduced by the fair market value of stock of Corporation FZ issued or provided by Corporation US1 to employees of Corporation US1. *See* paragraph (n) of this section.

(3) *Example 3: A single covered funding and covered purchase*—(i) *Facts.* Corporation FZ owns all the outstanding stock of Corporation US1, a domestic corporation. On March 1, 2024, Corporation US1 makes a distribution with respect to its stock of $600x to Corporation FZ. A principal purpose of the distribution is to fund a covered purchase. On May 15, 2026, Corporation FZ repurchases 100 shares of its stock when the fair market value of each share is $8x.

(ii) *Analysis.* Because a principal purpose of the distribution by Corporation US1 to Corporation FZ is to fund a covered purchase, the distribution of $600x is a covered funding. *See* paragraph (e)(1) of this section. The repurchase by Corporation FZ of its stock is an AFC repurchase and therefore a covered purchase. *See* paragraph (b)(2)(vii) of this section. The entire amount of the covered purchase, or $800x, is the allocable amount of the covered purchase. *See* paragraph (e)(5) of this section. The entire amount of the covered funding, or $600x, is allocated to the allocable amount of the covered purchase because the amount of the covered funding is less than the amount of the covered purchase. *See* paragraph (e)(7)(iii) of this section. The amount of stock of Corporation FZ acquired in the covered purchase that is treated as acquired by Corporation US1 is equal to the amount of covered fundings allocated to the allocable amount of the covered purchase, or $600x (which represents 75 of the 100 shares of stock repurchased). *See* paragraph (e)(4) of this section. Corporation US1 is treated as acquiring stock of Corporation FZ in a section 4501(d)(1) repurchase on May 15, 2026. *See* paragraphs (b)(2)(xxii)(B) and (k)(4) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base, the fair market value of the 75 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $600x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase by Corporation US1 increases its section 4501(d) excise tax base for the 2026 taxable year by $600x.

(4) *Example 4: Multiple covered fundings and a single covered purchase*—(i) *Facts.* The

facts are the same as in paragraph (p)(3)(i) of this section (*Example 3*), except that Corporation FZ also owns all the stock of Corporation FB, a foreign corporation. In addition, on April 15, 2024, Corporation FB makes a distribution with respect to its stock of $1,000x to Corporation FZ. Further, on October 15, 2024, Corporation US1 makes another distribution with respect to its stock of $400x to Corporation FZ. A principal purpose of the October 15, 2024, distribution is also to fund a covered purchase.

(ii) *Analysis.* Because a principal purpose of the distributions by Corporation US1 to Corporation FZ is to fund a covered purchase, each of the March 1, 2024, distribution of $600x and the October 15, 2024, distribution of $400x is a covered funding. *See* paragraph (e)(1) of this section. The repurchase by Corporation FZ of its stock is an AFC repurchase and therefore a covered purchase. *See* paragraph (b)(2)(vii) of this section. The entire amount of the covered purchase, or $800x, is the allocable amount of the covered purchase. *See* paragraph (e)(5) of this section. Further, the allocable amount of the covered purchase is treated as made first from the covered fundings. With respect to the covered fundings, the March 1, 2024, distribution by Corporation US1 is treated as funding the allocable amount of the covered purchase before the October 15, 2024, distribution by Corporation US1. *See* paragraphs (e)(6) and (e)(7)(iv) of this section. Accordingly, the entire amount of the March 1, 2024, distribution, or $600x, and $200x of the October 15, 2024, distribution is allocated to the allocable amount of the covered purchase. The amount of stock of Corporation FZ acquired in the covered purchase that is treated as acquired by Corporation US1 is equal to the amount of covered fundings allocated to the allocable amount of the covered purchase, or $800x (which represents the 100 shares of stock repurchased). *See* paragraph (e)(4) of this section. Corporation US1 is treated as acquiring stock of Corporation FZ in a section 4501(d)(1) repurchase on May 15, 2026. *See* paragraphs (b)(2)(xxii)(B) and (k)(4) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base, the fair market value of the 100 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $800x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase by Corporation US1 increases its section 4501(d) excise tax base for the 2026 taxable year by $800x.

(5) *Example 5: The rebuttable presumption*—(i) *Facts.* Corporation FZ owns all the outstanding stock of Corporation US1, a domestic corporation. Corporation US1 owns all the outstanding stock of Corporation FD, a foreign corporation. On March 1, 2024, Corporation US1 makes a capital contribution of $600x to Corporation FD. On May 15, 2024, Corporation FD acquires 100 shares of the stock of Corporation FZ when the fair market value of each share is $8x. The facts and circumstances do not clearly establish that there was not a principal purpose of avoiding the section 4501(d) excise tax as described in paragraph (e)(1) of this section.

(ii) *Analysis.* A principal purpose described in paragraph (e)(1) of this section is presumed to exist because Corporation FD is a downstream relevant entity and the capital contribution by Corporation US1 to Corporation FD occurs within two years of a covered purchase by Corporation FD. *See* paragraph (e)(2) of this section. Because the facts and circumstances do not clearly establish that there was not a principal purpose with respect to the March 1, 2024, capital contribution of avoiding the section 4501(d) excise tax as described in paragraph (e)(1) of this section, the presumption is not rebutted. *See* paragraph (e)(2) of this section. Accordingly, the capital contribution of $600x is a covered funding. *See* paragraph (e)(1) of this section. The acquisition by Corporation FD of the stock of Corporation FZ is an acquisition of stock of an applicable foreign corporation by a relevant entity and therefore a covered purchase. *See* paragraph (b)(2)(vii) of this section. The entire amount of the covered purchase, or $800x, is the allocable amount of the covered purchase. *See* paragraph (e)(5) of this section. The entire amount of the covered funding, or $600x, is allocated to the allocable amount of the covered purchase because the amount of the covered funding is less than the amount of the covered purchase. *See* paragraph (e)(7)(iii) of this section. The amount of stock of Corporation FZ acquired in the covered purchase that is treated as acquired by Corporation US1 is equal to the amount of covered fundings allocated to the allocable amount of the covered purchase, or $600x (which represents 75 of the 100 shares of stock repurchased). *See* paragraph (e)(4) of this section. Corporation US1 is treated as acquiring stock of Corporation FZ in a section 4501(d)(1) repurchase on May 15, 2024. *See* paragraphs (b)(2)(xxii)(B) and (k)(4) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base, the fair market value of the 75 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $600x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase by Corporation US1 increases its section 4501(d) excise tax base for the 2024 taxable year by $600x. Other covered fundings, if any, could be allocated to the remaining $200x of stock of Corporation FZ that Corporation FD acquired.

(6) *Example 6: Indirect funding subject to rebuttable presumption*—(i) *Facts.* Corporation FZ owns all the outstanding stock of each of Corporation US1, a domestic corporation and Corporation FB, a foreign corporation. Corporation US1 owns all the outstanding stock of Corporation FY, a foreign corporation. Corporation FY owns all the outstanding stock of Corporation FD, a foreign corporation. On March 1, 2024, Corporation US1 makes a loan of $1,000x to Corporation FB. On March 15, 2024, Corporation FB makes a loan of $900x to Corporation FD. The facts and circumstances do not clearly establish that there was not a principal purpose of avoiding the section 4501(d) excise tax as described in paragraph (e)(1) of this section. On May 15, 2024, Corporation FD acquires 100 shares of the stock of Corporation FZ when the fair market value of each share is $8x.

(ii) *Analysis.* A principal purpose described in paragraph (e)(1) of this section is presumed to exist because Corporation FD is a downstream relevant entity and the March 1, 2024, loan by Corporation US1 to Corporation FB occurs within two years of a covered purchase by Corporation FD. *See* paragraph (e)(2) of this section. Because the facts and circumstances do not clearly establish that there was not a principal purpose of avoiding the section 4501(d) excise tax as described in paragraph (e)(1) of this section, the presumption is not rebutted. *See* paragraph (e)(2) of this section. Accordingly, the March 1, 2024, loan is a covered funding. *See* paragraph (e)(1) of this section. The acquisition by Corporation FD of the stock of Corporation FZ is an acquisition of stock of an applicable foreign corporation by a relevant entity and therefore a covered purchase. *See* paragraph (b)(2)(vii) of this section. The entire amount of the covered purchase, or $800x, is the allocable amount of the covered purchase. *See* paragraph (e)(5) of this section. $800x of the covered funding is allocated to the allocable amount of covered purchase because the allocable amount of the covered purchase is less than the amount of the covered funding. *See* paragraph (e)(7)(iii) of this section. The amount of stock of Corporation FZ acquired in the covered purchase that is treated as acquired by Corporation US1 is equal to the amount of covered fundings allocated to the allocable amount of the covered purchase, or $800x (which represents the 100 shares of stock repurchased). *See* paragraph (e)(4) of this section. Corporation US1 is treated as acquiring stock of Corporation FZ in a section 4501(d)(1) repurchase on May 15, 2024. *See* paragraphs (b)(2)(xxii)(B) and (k)(4) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base, the fair market value of the 100 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $800x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase by Corporation US1 increases its section 4501(d) excise tax base for the 2024 taxable year by $800x.

(7) *Example 7: Indirect funding*—(i) *Facts.* Corporation FZ owns all the outstanding stock of two foreign corporations, Corporation FB and Corporation FE, and all the outstanding stock of two domestic corporations, Corporation US1 and Corporation US2. On March 1, 2024, Corporation US1 makes a loan of $700x to Corporation FZ. On April 1, 2024, Corporation FZ makes a loan to Corporation FB of $1,100x. On May 15, 2024, Corporation FE makes a loan of $900x to Corporation FB. On June 1, 2024, Corporation US2 makes a

loan of $800x to Corporation FZ. A principal purpose of each of the March 1, 2024, loan by Corporation US1 and the June 1, 2024, loan by Corporation US2 is to fund a covered purchase. On December 1, 2024, Corporation FB acquires 100 shares of stock of Corporation FZ when the fair market value of each share is $8x.

(ii) *Analysis.* Because a principal purpose of each of the March 1, 2024, loan by Corporation US1 and the June 1, 2024, loan by Corporation US2 is to fund a covered purchase, each of those loans is a covered funding. *See* paragraph (e)(1) of this section. The acquisition by Corporation FB of stock of Corporation FZ is an acquisition of stock of an applicable foreign corporation by a relevant entity and therefore a covered purchase. *See* paragraph (b)(2)(vii) of this section. The entire amount of the covered purchase, or $800x, is the allocable amount of the covered purchase. *See* paragraph (e)(5) of this section. The March 1, 2024, loan by Corporation US1 and the June 1, 2024, loan by Corporation US2 are treated as funding the allocable amount of the covered purchase before the May 15, 2024, loan by Corporation FE. *See* paragraph (e)(5) of this section. Further, the March 1, 2024, loan by Corporation US1 is treated as funding the allocable amount of the covered purchase before the June 1, 2024, loan by Corporation US2. *See* paragraph (e)(7)(iv) of this section. Accordingly, the entire amount of the March 1, 2024, loan, or $700x, and $100x of the June 1, 2024, loan is allocated to the allocable amount of the covered purchase. The amount of stock of Corporation FZ acquired in the covered purchase that is treated as acquired by Corporation US1 is the amount of covered fundings by Corporation US1 allocated to the allocable amount of the covered purchase, or $700x (which represents the 87.5 shares of stock repurchased). The amount of stock of Corporation FZ acquired in the covered purchase that is treated as acquired by Corporation US2 is equal to the amount of covered fundings by Corporation US2 allocated to the allocable amount of the covered purchase, or $100x (which represents the 12.5 shares of stock repurchased). *See* paragraph (e)(4) of this section. Corporation US1 and Corporation US2 are each treated as acquiring stock of Corporation FZ in a section 4501(d)(1) repurchase on December 1, 2024. *See* paragraphs (b)(2)(xxii)(B) and (k)(4) of this section. Each of Corporation US1 and Corporation US2 is a section 4501(d) covered corporation with respect to its portion of the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base, the fair market value of the 87.5 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $700x. For purposes of computing Corporation US2's section 4501(d) excise tax base, the fair market value of the 12.5 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $100x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase by Corporation US1 increases its section 4501(d) excise tax base for the 2024 taxable year by $700x, and the section 4501(d)(1) repurchase by Corporation US2 increases its section 4501(d) excise tax base for the 2024 taxable year by $100x.

(8) *Example 8: A foreign partnership that is an applicable specified affiliate*—(i) *Facts.* Partnership FP is a foreign partnership in which Corporation FZ, Corporation FB, a foreign corporation, and Corporation US1, a domestic corporation, are partners. Corporation FZ owns 70 percent of the capital interests and profits interests of Partnership FP; Corporation FB owns 20 percent of the capital interests and profits interests of Partnership FP; and Corporation US1 owns 10 percent of the capital interests and profits interests of Partnership FP. On March 1, 2024, Partnership FP purchases 100 shares of stock of Corporation FZ when the fair market value of each share is $8x.

(ii) *Analysis.* Corporation US1 is a domestic entity. *See* paragraph (b)(2)(x) of this section. Corporation US1 is a direct partner with respect to Partnership FP for purposes of section 4501(d)(1) because Corporation US1 directly owns an interest in Partnership FP and is not a de minimis domestic entity partner with respect to Partnership FP. *See* paragraphs (h)(2)(i) and (h)(5) of this section. Accordingly, Partnership FP is an applicable specified affiliate of Corporation FZ because Corporation FZ owns more than 50 percent of the capital interests or profits interests of Partnership FP, and Corporation US1, a domestic entity, is a direct partner of Partnership FP. Partnership FP's purchase of 100 shares of stock of Corporation FZ is a section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xxii)(A) of this section. Partnership FP is a section 4501(d) covered corporation with respect to the section 4501(d)(1) repurchase. *See* paragraph (b)(2)(xv)(A) of this section. For purposes of computing Partnership FP's section 4501(d) excise tax base, the fair market value of the 100 shares of stock of Corporation FZ subject to the section 4501(d)(1) repurchase is $800x. *See* paragraph (l) of this section. Accordingly, the section 4501(d)(1) repurchase increases Partnership FP's section 4501(d) excise tax base for the 2024 taxable year by $800x.

(9) *Example 9: A foreign partnership that is not an applicable specified affiliate*—(i) *Facts.* The facts are the same as in paragraph (p)(8)(i) of this section (*Example 8*), except that Corporation FZ owns 76 percent of the capital interests and profits interests of Partnership FP; Corporation FB owns 20 percent of the capital interests and profits interests of Partnership FP; and Corporation US1 owns 4 percent of the capital interests and profits interests of Partnership FP.

(ii) *Analysis.* Corporation US1 is not a direct or indirect partner with respect to Partnership FP for purposes of section 4501(d)(1) because Corporation US1 qualifies as a de minimis domestic entity partner. *See* paragraph (h)(5) of this section. Partnership FP is not an applicable specified affiliate of Corporation FZ because Partnership FP has no direct or indirect domestic entity partner. Accordingly, Partnership FP's purchase of 100 shares of stock of Corporation FZ is not treated as a section 4501(d)(1) repurchase.

(10) *Example 10: A foreign partnership that is directly owned by foreign corporations and is an applicable specified affiliate*—(i) *Facts.* Corporation FZ owns all the outstanding stock of Corporation US1, a domestic corporation. Corporation US1 owns all the outstanding stock of Corporation FB, a foreign corporation. Partnership FP is a foreign partnership in which Corporation FB and Corporation FE, a foreign corporation, are partners. Corporation FB owns 80 percent of the capital interests and profits interests of Partnership FP, and Corporation FE owns 20 percent of the capital interests and profits interests of Partnership FP.

(ii) *Analysis.* Corporation US1 is a domestic entity. *See* paragraph (b)(2)(x) of this section. Corporation US1 owns an interest in Partnership FP indirectly through Corporation FB, a foreign corporation that Corporation US1 controls within the meaning of paragraph (h)(3) of this section. Corporation US1 does not qualify as a de minimis domestic entity partner with respect to Partnership FP. *See* paragraph (h)(5) of this section. Corporation US1 is thus an indirect partner with respect to Partnership FP for purposes of section 4501(d)(1). *See* paragraph (h)(2)(ii)(B) of this section. Accordingly, Partnership FP is an applicable specified affiliate of Corporation FZ because Corporation FZ indirectly owns more than 50 percent of the capital interests or profits interests of Partnership FP and Corporation US1, a domestic entity, is an indirect partner of Partnership FP.

(q) *Section 4501(d)(2) examples.* The following examples illustrate the application of the rules in this section relating to section 4501(d)(2). For purposes of the following examples, unless otherwise stated: Corporation FZ is a covered surrogate foreign corporation; each domestic entity is an expatriated entity within the meaning of section 7874(a)(2)(A) with respect to Corporation FZ and is not a member of a U.S. consolidated group; there are not any expatriated entities with respect to Corporation FZ other than as described in the facts; a reference to ownership refers to direct ownership; any repurchase or acquisition of stock is during a taxable year that includes at least a portion of the applicable period with respect to Corporation FZ under section 7874(d)(1); each entity has a calendar taxable year; each corporation's only outstanding stock is a single class of common stock; the functional currency (within the meaning of section 985) of any entity is the U.S. dollar; no stock is transferred to any employee; for examples that expressly provide that stock is transferred to any employee, such transfer is made in connection with the employee's performance of services in its capacity as an employee of the transferor, and the employee is treated as the beneficial owner of the stock for Federal income tax purposes on the date of the transfer; and the section 4501(d) statutory exceptions are inapplicable.

(1) *Example 1: The section 4501(d) netting rule with respect to an expatriated entity*—(i) *Facts.* Corporation FZ owns all the outstanding stock of Corporation US1, a domestic corporation. Employee M is an employee of Corporation FZ, and Employee P is an employee of Corporation US1. On February 1, 2024, Corporation US1 purchases 100 shares of stock of Corporation FZ when the fair market value of each share is $8x. On May 15, 2024, Corporation FZ transfers to Employee M 50 shares of stock of Corporation FZ when the fair market value of each share is $5x. On November 1, 2024, Corporation US1 transfers to Employee P 30 shares of stock of Corporation US1 when the fair market value of each share is $9x. On December 15, 2024, Corporation FZ purchases 90 shares of its stock when the fair market value of each share is $12x.

(ii) *Analysis.* Each of Corporation US1's purchase of 100 shares of stock of Corporation FZ and Corporation FZ's purchase of 90 shares of its stock is a section 4501(d)(2) repurchase. *See* paragraph (b)(2)(xxiii) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(2) repurchases. *See* paragraph (b)(2)(xv)(B) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base, the fair market value of the 100 shares of stock of Corporation FZ subject to the section 4501(d)(2) repurchase on February 1, 2024, is $800x, and the fair market value of the 90 shares of stock of Corporation FZ subject to the section 4501(d)(2) repurchase on December 15, 2024, is $1,080x. *See* paragraph (l) of this section. The section 4501(d)(2) repurchases thus increase Corporation US1's section 4501(d) excise tax base for the 2024 taxable year by $1,880x ($800x + $1,080x). Corporation US1's section 4501(d) excise tax base for its 2024 taxable year is not reduced by the fair market value of the stock of Corporation FZ transferred to Employee M or the fair market value of the stock of Corporation US1 transferred to Employee P because the section 4501(d) excise tax base with respect to Corporation US1 can only be reduced by the fair market value of stock of Corporation FZ issued or provided by Corporation US1 to employees of Corporation US1. *See* paragraph (n) of this section. Accordingly, Corporation US1's section 4501(d) excise tax base with respect to these transactions for its 2024 taxable year is $1,880x.

(2) *Example 2: Section 4501(d)(2) repurchase from the covered surrogate foreign corporation or another specified affiliate of the covered surrogate foreign corporation*—(i) *Facts.* Corporation FZ owns all the outstanding stock of each of Corporation US1, a domestic corporation, Corporation FB, a foreign corporation, and Corporation FE, a foreign corporation. On February 1, 2024, Corporation US1 purchases 100 shares of stock of Corporation FZ from Corporation FB when the fair market value of each share is $8x. On December 15, 2024, Corporation FZ contributes 90 shares of its stock to Corporation FE when the fair market value of each share is $12x.

(ii) *Analysis.* Each of Corporation US1's purchase of 100 shares of stock of Corporation FZ and Corporation FZ's transfer of 90 shares of its stock is a section 4501(d)(2) repurchase. *See* paragraph (b)(2)(xxiii) of this section. Corporation US1 is a section 4501(d) covered corporation with respect to the section 4501(d)(2) repurchases. *See* paragraph (b)(2)(xv)(B) of this section. For purposes of computing Corporation US1's section 4501(d) excise tax base, the fair market value of the 100 shares of stock of Corporation FZ subject to the section 4501(d)(2) repurchase on February 1, 2024, is $800x, and the fair market value of the 90 shares of stock of Corporation FZ subject to the section 4501(d)(2) repurchase on December 15, 2024, is $1,080x. *See* paragraph (l) of this section. Accordingly, Corporation US1's section 4501(d) excise tax base with respect to these transactions for its 2024 taxable year is $1,880x.

(3) *Example 3: Liability with respect to multiple expatriated entities*—(i) *Facts.* Corporation FZ owns all the outstanding stock of each of Corporation US1, a domestic corporation, and Corporation US2, a domestic corporation. Employee M is an employee of Corporation US1, and Employee P is an employee of Corporation US2. On February 1, 2024, Corporation US1 purchases 100 shares of stock of Corporation FZ when the fair market value of each share is $8x. On May 15, 2024, Corporation US2 purchases 40 shares of stock of Corporation FZ when the fair market value of each share is $9x. On October 15, 2024, Corporation FZ repurchases 50 shares of its stock when the fair market value of each share is $7x. On November 1, 2024, Corporation US1 transfers to Employee M 30 shares of stock of Corporation FZ when the fair market value of each share is $9x. On November 20, 2024, Corporation US2 transfers to Employee P 30 shares of stock of Corporation FZ when the fair market value of each share is $8x. Corporation US1 pays the entire amount of section 4501(d) excise tax that it owes with respect to all section 4501(d)(2) repurchases relating to Corporation FZ and its specified affiliates that occur during Corporation US1's 2024 taxable year and fulfills its filing obligations for its 2024 taxable year with respect to such section 4501(d)(2) repurchases.

(ii) *Analysis.* Each of Corporation US1's purchase of 100 shares of stock of Corporation FZ, Corporation US2's purchase of 40 shares of stock of Corporation FZ, and Corporation FZ's repurchase of 50 shares of its stock is a section 4501(d)(2) repurchase. *See* paragraphs (b)(2)(xxiii) and (d)(2)(i) of this section. Each of Corporation US1 and Corporation US2 is a section 4501(d) covered corporation with respect to the section 4501(d)(2) repurchases. *See* paragraph (b)(2)(xv)(B) of this section. For purposes of computing the section 4501(d) excise tax base for each of Corporation US1 and Corporation US2, the fair market value of the 100 shares subject to the section 4501(d)(2) repurchase on February 1, 2024, is $800x; the fair market value of the 40 shares of stock of Corporation FZ subject to the section 4501(d)(2) repurchase on May 15, 2024, is $360x; and the fair market value of the 50 shares of stock of Corporation FZ subject to the section 4501(d)(2) repurchase on October 15, 2024, is $350x. *See* paragraph (l) of this section. The section 4501(d)(2) repurchases thus increase each of Corporation US1's and Corporation US2's section 4501(d) excise tax base for the 2024 taxable year by $1,510x ($800x + $360x + $350x). 30 shares of Corporation FZ stock are treated as issued or provided to Employee M on November 1, 2024. *See* paragraph (n) of this section. Therefore, Corporation US1's section 4501(d) excise tax base is reduced for its 2024 taxable year by the fair market value of the 30 shares of stock of Corporation FZ transferred on November 1, 2024, or $270x ($9x per share x 30 shares = $270x). *See* paragraph (c)(3)(i)(C) of this section. Corporation US1's section 4501(d) excise tax base for its 2024 taxable year is not reduced by the fair market value of the stock of Corporation FZ that Corporation US2 transferred to Employee P because the section 4501(d) excise tax base with respect to Corporation US1 can only be reduced by the fair market value of stock of Corporation FZ issued or provided by Corporation US1 to employees of Corporation US1. *See* paragraph (n) of this section. Accordingly, Corporation US1's section 4501(d) excise tax base with respect to these transactions for its 2024 taxable year is $1,240x ($1,510x − $270x). Because Corporation

US1 pays the entire amount of section 4501(d) excise tax that it owes with respect to all section 4501(d)(2) repurchases that occur during Corporation US1's 2024 taxable year relating to Corporation FZ and its specified affiliates and fulfills its filing obligations for its 2024 taxable year with respect to such section 4501(d)(2) repurchases, Corporation US2 is not liable for section 4501(d) excise tax with respect to such section 4501(d)(2) repurchases. *See* paragraph (d)(2)(ii) of this section.

(r) *Applicability dates*—(1) *In general.* Except as provided in paragraphs (e)(1) and (r)(3) of this section, the provisions of this section (other than paragraph (o) of this section) apply to transactions that occur after April 12, 2024.

(2) *Rules applicable before* April 13, 2024. Except as provided in paragraphs (o)(2) and (r)(3) of this section, the rules in paragraph (o) of this section apply to transactions that occur after December 31, 2022, and on or before April 12, 2024.

(3) *Early application.* A section 4501(d) covered corporation may choose to apply all the rules of this section (other than paragraphs (o), (r)(1), and (r)(2) of this section) to transactions occurring after December 31, 2022, subject to paragraph (e)(1) of this section. A section 4501(d) covered corporation may choose to apply the rules of this section (other than paragraphs (o) and (r)(1) and (2) of this section) pursuant to the immediately preceding sentence only if the section 4501(d) covered corporation and all other section 4501(d) covered corporations with respect to the same applicable foreign corporation or covered surrogate foreign corporation, as applicable, consistently apply all the rules of this section (other than paragraphs (o) and (r)(1) and (2) of this section) as described in the immediately preceding sentence.

Subpart B [Reserved]

Douglas W. O'Donnell,

Deputy Commissioner for Services and Enforcement.

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