

Section 4501 Excise Tax on Stock Repurchases

An In-Depth Look at the NYSBA Tax Section Report

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Basics of Section 4501

- 1% excise tax on the FMV of net “**repurchases**” by a “**covered corporation**” or its “**specified affiliates**” of the covered corporation’s “**stock**”
- Non-deductible for federal income tax purposes
- Applies to repurchases after Dec. 31, 2022
- A late addition to the “Inflation Reduction Act” to supplement the revenue score after the “carried interest” provision was removed
 - Originally proposed in 2021 and included in the draft “Build Back Better Act”

Policy Reasons for the Excise Tax

- Legislative history is sparse, but Congress apparently enacted the excise tax: (i) to discourage publicly traded corporations from repurchasing stock (instead of investing in their business operations) and (ii) to impose friction costs on such repurchases to raise revenue
- Congress apparently believed that corporations may repurchase stock:
 - To opportunistically drive-up their stock price, perhaps using insider knowledge
 - To manipulate EPS to enrich executives with equity compensation packages tied to EPS
- Congress also apparently disliked how buybacks allow non-selling shareholders to accrete proportionate ownership of the redeeming corporation tax-free
- Further, there was also an apparent focus on the generally more favorable tax treatment of stock redemptions subject to section 302(a) as opposed to dividends

Threshold Issue: Possible Approaches To Guidance

- Possible approaches to section 4501 guidance:
 - Adhere to the literal text in guidance
 - Tailor guidance based on apparent congressional intent in order to rationalize the scope of the excise tax
- Which approach you follow has major consequences for the scope of the excise tax
- As described in the report, majority generally favored the second approach, but the debate was largely a matter of degree

Covered Corporation

- **Covered corporation:** a “domestic corporation the stock of which is traded on an established securities market (within the meaning of section 7704(b)(1)).” Section 4501(b)
 - Unlike new book AMT, no minimum revenue threshold
 - Special rules for acquisitions of stock of: (i) foreign covered corporations by certain U.S. subsidiary entities, and (ii) certain surrogate foreign corporations.
- Section 7704 Treasury Regulations define “established securities market” as:
 - Various types of securities exchanges
 - “An interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise.”
Treas. Reg. 1.7704-1(b)(5)
- Can a corporation become a covered corporation without knowing it?

Covered Corporation: Report Recommendations

- The report discusses two primary points on the definition of a covered corporation:
 - If the corporation has **any** stock that is traded on an established securities market, **all** stock of the corporation is apparently subject to the excise tax
 - For corporation traded on an “interdealer quotation system,” a “non-involvement safe harbor” in Treas. Reg. 1.7704-1(d) applies in the PTP context
- The report recommends that guidance affirm that the non-involvement safe harbor applies for section 4501 purposes, with any necessary adjustments for application to corporations as opposed to partnerships

Repurchases

- A **repurchase** is:
 - A redemption (within the meaning of section 317(b)) of stock of a covered corporation (a “**Section 317(b) Redemption**”); and
 - Any transaction “determined by the Secretary to be economically similar” to a Section 317(b) Redemption. Section 4501(c)(1)
- Section 317(b) Redemption: “[f]or purposes of this part” – i.e., for purposes of sections 301-318) – a transaction in which a “corporation acquires its stock from a shareholder in exchange for property”
- The definition of “repurchase” gives rise to two primary interpretive questions:
 - What should be treated as a “redemption” or economically similar?
 - What should be treated as “stock”? (Refer to instruments subject to excise tax as **Covered Instruments**)

Definition of “Redemption”

- Arguably unclear whether a section 331 liquidation is a Section 317(b) Redemption, and thus a “repurchase”
 - Section 317(b) defines when stock is treated as redeemed “for purposes of this part”
 - “This Part” = Part A of Subchapter C, which encompasses sections 301-318 (i.e., **not** section 331)
- Arguable that section 317(b) does **not** apply to section 331 distributions or other transactions that have (or are deemed to have) a redemption-type element, but are **not** governed by sections 301-318 (e.g., sections 355/368)
 - The IRS has ruled, in the context of section 303, that a Section 331 distribution is a Section 317(b) Redemption “for purposes of section 303, **even though section 317(b) does not apply to section 331.**” Rev. Rul. 79-401, 1979-2 C.B. 128 (emphasis added); *see also* Rev. Rul. 73-177, 1973-1 C.B. 168
 - In a brief analysis, a TAM stated that the redemptive element in a section 368 reorganization is a Section 317(b) Redemption. TAM 9627003 (Feb. 28, 1996)
- An issue for SPACs that has apparently motivated certain pre-2023 SPAC liquidations

Definition of “Redemption”: Report Recommendations on 331 Liquidations

- The report recommends that guidance define “repurchase” to **exclude** section 331 liquidations because they are economically different in kind from redemptions by corporations that continue to exist
- Section 331 liquidations, by definition, permanently dissolve the corporation and cease its business operations, and thus completely terminate all equity interests in the corporation
 - These liquidations are not a return of capital or earnings from an ongoing business operation, which could instead be reinvested in that business by the corporation
 - There can be no concerns about stock price manipulation and accretion to non-redeemed shareholders where the corporation ceases to exist and all shareholders are cashed out pro rata
- Overall, section 331 liquidations bear virtually no resemblance to the types of conventional stock repurchases that apparently motivated the enactment of section 4501

Definition of “Redemption” (Cont’d)

- Another topic is whether so-called “bootstrap acquisitions” should be subject to the excise tax
- Fully taxable stock acquisitions often feature elements that are treated as Section 317(b) Redemptions
 - A portion of the sale consideration may be sourced from Target’s cash on hand or from new Target debt
 - The transaction could be an all-cash merger whereby Target merges with a transitory merger subsidiary owned by acquiror and cash is delivered to Target shareholders as consideration in extinguishment of Target stock
- The portion of the purchase price funded by Target (the “**Target-Funded Payment**”) is treated as a Section 317(b) Redemption

Definition of “Redemption”: Report Recommendations on Target-Funded Payments

- The report recommends that the Target-Funded Payments in the fact patterns discussed above be excluded from the excise tax
- These transactions bear none of the hallmarks of opportunistic stock repurchases that apparently motivated Congress to enact the excise tax
 - All shareholders of Target are typically cashed out in the acquisition
 - The Target-Funded Payment does not result in manipulation of Target’s EPS or otherwise impact its post-closing share price in manner that concerned Congress

Definition of “Stock”: Report Recommendations

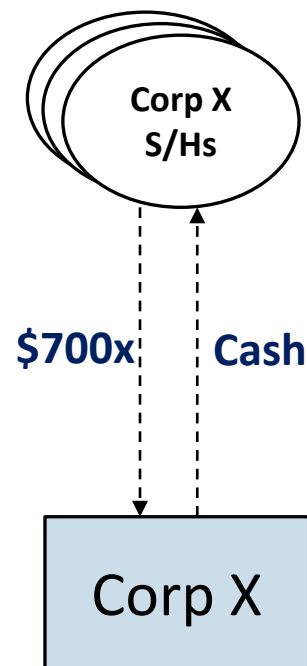
- A redemption of preferred stock is a Section 317(b) Redemption
- Section 4501(f) grants specific authority “to address . . . preferred stock”
- The report recommends that guidance exclude “preferred stock” from the definition of “stock” for excise tax purposes
 - Recommends definition by cross-reference to section 1504(a)(4) (but without regard to the requirements of section 1504(a)(4)(A) (non-voting requirement) & (C) (limitation to a reasonable redemption premium)
 - Section 1504(a)(4)(B) is core economic definition of preferred stock developed under Treas. Reg. 1.305-5 (“limited and preferred as to dividends and does not participate in corporate growth to any significant extent”)
 - Section 1504(a)(4)(D) prohibits from being “convertible into another class of stock”
- If excluded, issuances of preferred stock should be ignored for the netting rule (“Instrument-Type Matching Principle”)
- Further, an exchange of an outstanding covered instrument for preferred stock should be defined as “economically similar” to a Section 317(b) Redemption

The Netting Rule

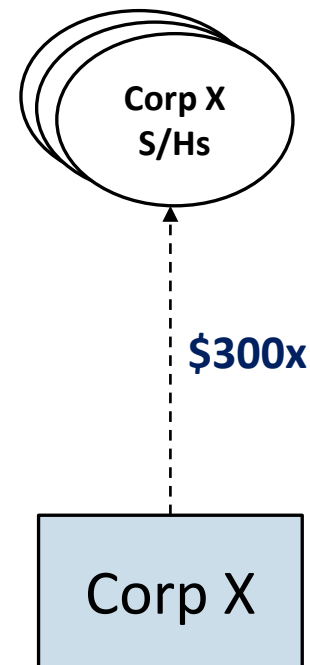
- The excise tax applies to a net, rather than gross, measure of stock repurchases during each taxable year
- Section 4501(c)(3):
 - “The amount taken into account under [section 4501(a)] with respect to any stock repurchased by a covered corporation [i.e., the value of stock repurchases subject to the excise tax] **shall be 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 such covered corporation or employees of a specified affiliate of such covered corporation during the taxable year, whether or not such stock is issued or provided in response to the exercise of an option to purchase such stock.” (emphasis added)
- Only able to net issuances against repurchases “during the taxable year”
 - If the tax year closes in an extraordinary transaction (e.g., a reverse acquisition), then apparently no netting across those tax years
- No apparent mechanism to net redemptions/issuances by different issuers
 - For example, Target, a covered corporation, redeems (or is treated as redeeming) Target shares, while Acquiror issues Acquiror stock to Target shareholders in an acquisition of Target that closes Target’s tax year
 - Apparently no netting of Target redemptions and Acquiror issuances

The Netting Rule: Simple Example

March of Year 1



August of Year 1



- In Year 1, Corp X (a calendar year taxpayer) repurchases \$700x of its stock in March and issues \$300x of stock in August
- *Excise tax liability*: $(\$700x \text{ repurchase} - \$300x \text{ issuance}) * 1\% = \$400x * 1\% = \$4x$

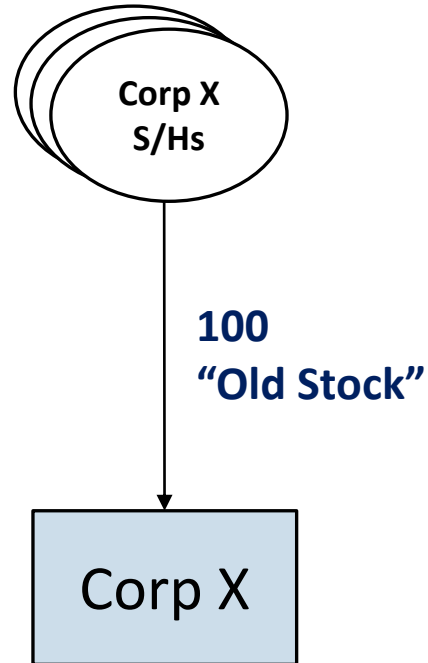
* Assume for all examples that Corp X is a covered corporation

The Netting Rule: Report Recommendations

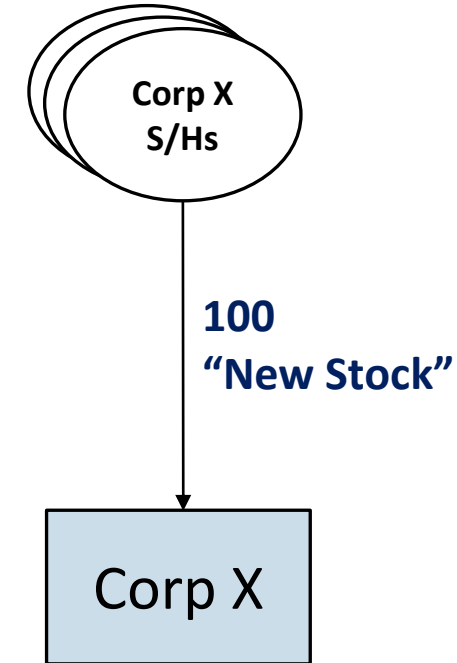
- **Instrument Type Matching Principle:** Report recommends that where the acquisition or redemption of a particular type or class of instrument does or does not constitute a “repurchase,” the issuance of that same type or class of instrument also should or should not constitute an issuance
- **Issuances/Exchanges in Respect of Existing Equity:** Report also recommends that certain stock distributions and exchanges in respect of existing equity be excluded from the definition of “issuance.” Specifically, the report recommends that the definition of “issuance” generally exclude:
 - Non-dilutive, tax free distribution of stock that constitutes a covered instrument (“**covered stock**”) with respect to the corporation’s existing covered stock within the meaning of section 305(a)
 - Stock splits, reverse stock splits, and other actual or deemed exchanges of newly issued covered stock for a corporation's existing covered stock in a non-dilutive, tax-free recapitalization within the meaning of section 368(a)(1)(E)
 - A transaction described in section 1036
 - A reorganization described in section 368(a)(1)(F)

The Netting Rule: Recapitalization Example

Pre-Exchange



Post-Exchange

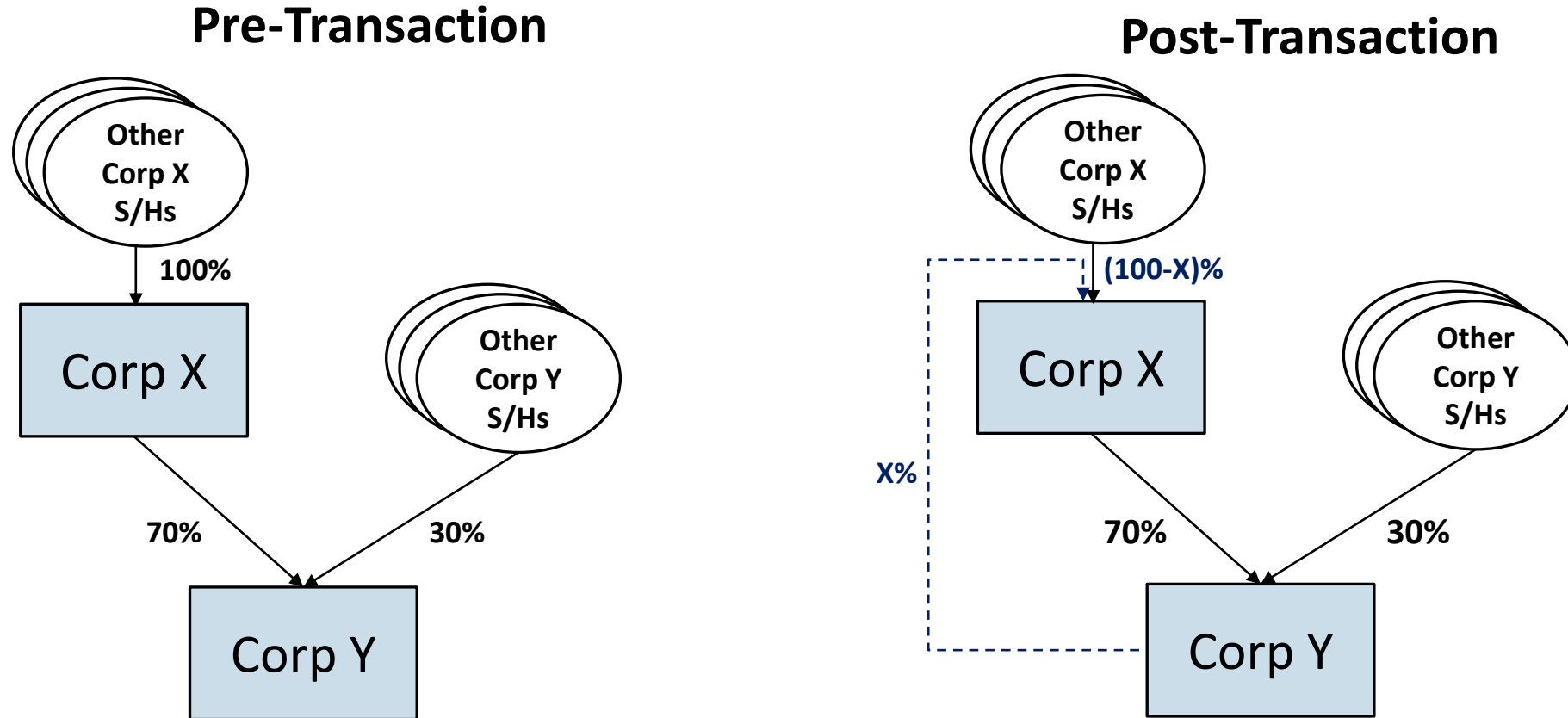


- Corp X has 100 shares of common stock outstanding and no other outstanding equity
- Corp X exchanges its common stock (the “**Old Stock**”) for new common stock (the “**New Stock**”)
- The Old Stock and New Stock have formal terms that differ to a material enough degree for the exchange to be treated as an equity recapitalization for federal income tax purposes, but without diluting or altering the Corp X shareholders’ proportionate equity interests in Corp X
- See, e.g., Rev. Rul. 69-407, 1969-2 C.B. 50 (exchange of \$150 par value common for \$100 par value old common stock, and of \$87.50 par value common stock for old \$100 par value common treated as a recapitalization); Rev. Rul. 54-482, 1954-2 C.B. 148 (exchange of no par value common stock for new \$1 par value common stock treated as a recapitalization), *amplified*, Rev. Rul. 86-25, 1986-1 C.B. 202

Specified Affiliates

- A **specified affiliate** is:
 - Any corporation more than 50% of the stock of which is owned (by vote or by value), directly or indirectly, by a covered corporation; and
 - Any partnership more than 50% of the capital interests or profits interests of which is held, directly or indirectly, by such corporation. Section 4501(c)(2)(B)
- Thus, a covered corporation’s “specified affiliates” are corporations and partnerships directly or indirectly controlled by the covered corporation, with “control” generally defined as equity ownership of greater than 50 percent

Specified Affiliates: Simple Example*



- Corp Y, a 70%-owned subsidiary of Corp X, buys \$70x of Corp X stock for cash
- Because Corp Y is a “specified affiliate” of Corp X, this transaction is a “repurchase” subject to the excise tax

Section 4501(e) Exceptions

- Section 4501(e) provides that certain types of repurchases are **not** subject to the excise tax:
 - *Reorganizations*: “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”
 - *Employee Plans*: “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, or similar plan”
 - *De minimis*: “in any case in which the total value of the stock repurchased during the taxable year does not exceed \$1,000,000”
 - *Dealers*: “under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business”
 - *RICs/REITs*: “repurchases by a regulated investment company (as defined in section 851) or a real estate investment trust”
 - *Dividends*: “to the extent that the repurchase is treated as a dividend for purposes of this title”

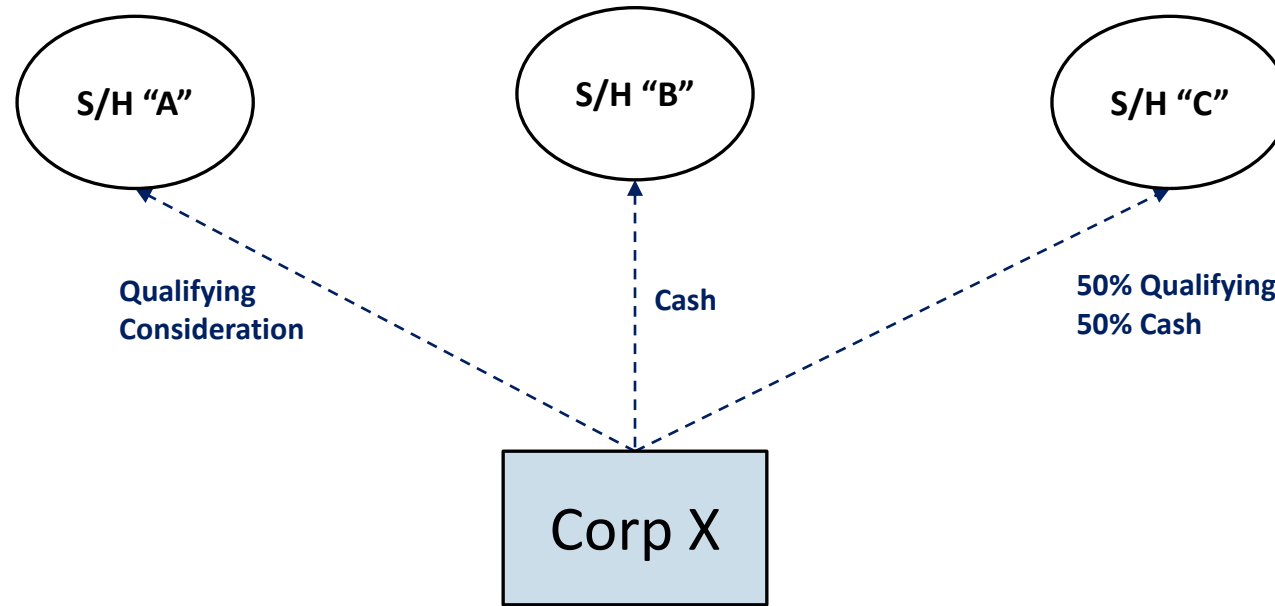
Reorganization Exception

- The reorganization exception in section 4501(e)(1) (the “**Reorganization Exception**”) applies only to the extent two requirements are met:
 - The repurchase is part of a reorganization within the meaning of section 368(a); and
 - The shareholder recognizes no gain or loss on the repurchase under chapter 1 of the Code (i.e., for federal income tax purposes)
- Each prong presents topics for potential guidance
 - “**Part of a Reorganization**”: “Naked” section 355 transactions are not literally covered
 - “D/355” transactions are arguably covered, but note that non-recognition must be “by reason of” reorganization status for the Reorganization Exception to apply
 - **No Gain or Loss Is Recognized**: The covered corporation generally will not know shareholder-level gain/loss
 - Further, shareholder loss generally not recognized in a reorganization under section 356(c)

Reorganization Exception: Report Recommendations

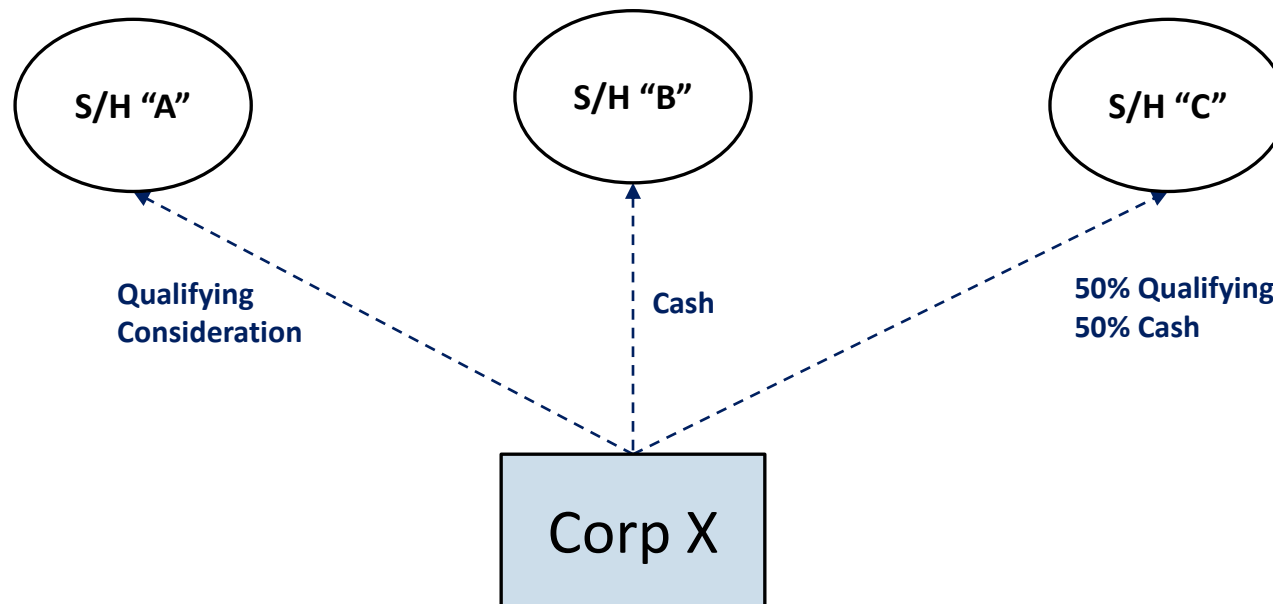
- Report recommends that guidance apply the Reorganization Exception to all tax-free section 355 transactions, and puts forward two possible approaches to “gain/loss” requirement:
 - **“Type of Consideration” Approach:** Applicability of the Reorganization Exception determined based solely on the type of consideration received in exchange for each share, regardless of the shareholder’s recognized gain or loss with respect to that share
 - Under this approach, the Reorganization Exception is available to the extent stock is exchanged for qualifying consideration under section 354 or 355, and is not available to the extent that stock is exchanged for boot
 - **“G/L Presumption” Approach:** To the extent that stock is exchanged for boot, shareholders presumed to recognize gain or loss to the full extent of boot received and are presumed ineligible for the Reorganization Exception
 - An entity could, however, rebut the G/L Presumption to the extent that the entity demonstrates that its shareholders recognized gain or loss (or lack thereof) in the reorganization

Reorganization Exception: A Simple Example



- Corp X has 100 shares of common stock outstanding and no other outstanding equity; engages in reorganization within the meaning of section 368(a)
- Shareholder A exchanges its existing Corp X common stock ("**old stock**") solely for qualifying consideration
- Shareholder B exchanges old stock solely for cash
- Shareholder C exchanges its old stock for a 50/50 mix of qualifying consideration and cash

Reorganization Exception: A Simple Example



Approach	Shareholder A	Shareholder B	Shareholder C
Type of Consideration	Exception applies	Exception does not apply regardless of recognized gain/loss (or lack thereof)	Exception applies to the extent qualifying consideration is received and does not apply to the extent boot is received
G/L Presumption	Exception applies	Exception does not apply <i>except to the extent G/L Presumption is rebutted</i>	Exception applies to the extent qualifying consideration is received and does not apply to the extent boot is received <i>except to the extent G/L Presumption is rebutted</i>

Reorganization Exception: Report Recommendations (Cont'd)

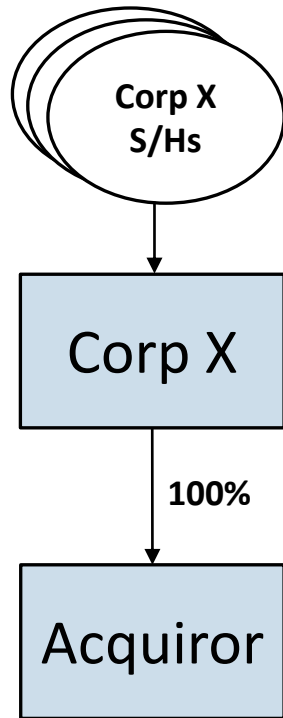
- The report concludes that the Type of Consideration Approach is preferable from a policy perspective, but is less faithful to the plain language of the Reorganization Exception
- The report concludes that the G/L Presumption approach is inferior as a policy matter, but gives fuller effect to the statutory language
- As a result, the report recommends the Type of Consideration Approach if Treasury concludes that it has the regulatory authority to support it, and recommends the G/L Presumption approach if Treasury reaches the opposite conclusion

Reorganizations Outside the Exception: Boot in Reorganizations

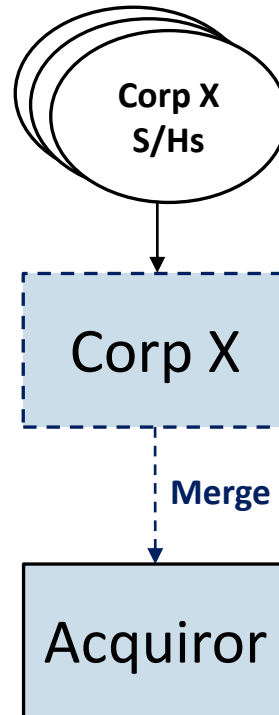
- To the extent that the Reorganization Exception does not apply to a reorganization, it is unclear how the excise tax should apply
- Acquisitive asset reorganizations include deemed liquidating distribution from Target (arguably, a Section 317(b) Redemption); stock reorganizations do not include a deemed redemptive step
 - One could make the same argument here as for section 331 liquidations that redemptive element of asset reorganizations is not a Section 317(b) Redemption
 - But perhaps hard to argue, given the negative implication of the Reorganization Exception?
- The report argues that it is unclear why boot in an acquisitive reorganization should be treated worse than taxable consideration in a straight section 1001 sale of stock
- But also, certain reorganizations implicate the policies of the excise tax:
 - Equity recapitalizations with non-*Bazley* boot
 - Downstream asset and stock reorganizations with boot
 - Split-offs with boot

Boot in Reorganizations: Downstream Example

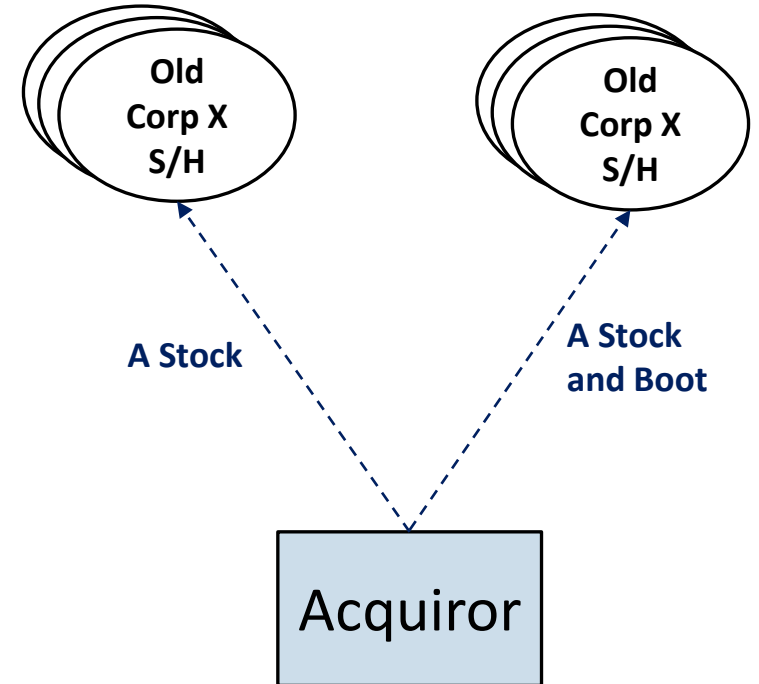
Pre-Reorg



Downstream Merger



Consideration



- Corp X wholly owns Acquiror
- In an acquisitive asset reorganization, Corp X merges downstream into Acquiror
- Some Corp X shareholders receive only Acquiror stock, while other Corp X shareholders receive a mix of Acquiror stock and boot. The receipt of boot is taxed as a section 302(a) exchange under section 356(a)(2) and *Clark*

Boot in Reorganizations: Report Recommendations

- The report recommends that “repurchase” be defined generally to exclude the receipt of boot in a deemed liquidating distribution in an acquisitive asset reorganization
 - Does not bear the hallmarks of a conventional stock repurchase
 - Only potentially a “redemption” because of historical Subchapter C principles that do not appear to implicate the excise tax’s policy concerns
 - Unclear why the excise tax would apply to acquisitive asset reorganizations but not acquisitive stock reorganizations (or many taxable stock acquisitions)
- The report recommends that boot in acquisitive stock reorganizations (A/(a)(2)(E) reorganizations) not be defined as “economically similar” for analogous policy reasons
- As an anti-avoidance measure, the report recommends that downstream mergers like our example be subject to the excise tax
 - The report also notes that Treasury could consider a broader anti-avoidance rule where Target and Acquiror are under common control
- The report also recommends that “repurchase” be defined to include:
 - Non-*Bazley* boot in equity recapitalization
 - Boot in section 355 split-offs

Dividend Exception

- Under section 4501(e)(6) (the “**Dividend Exception**”), the excise tax does not apply “to the extent that the repurchase is treated as a dividend for purposes of this title.”
 - The amount of a distribution “which is a dividend” for purposes of the Code is the portion of a distribution that is made out of a corporation’s current or accumulated E&P
- Clear that Congress intended to exempt from the excise tax the portion of a distribution that constitutes a “dividend” under section 301(c)(1). But did Congress intend the excise tax to apply to the portion of a distribution that is treated as a return of basis under section 301(c)(2) or gain from the sale or exchange under section 301(c)(3)?
- An actual distribution of property governed by section 301(a) is not a Section 317(b) Redemption because the distributing corporation is not acquiring its stock from its shareholders
 - Thus, an actual distribution subject to section 301(c)(2)-(3) could be subject to the excise tax if defined as “economically similar” to a Section 317(b) Redemption
- A deemed distribution under section 302(d) is eligible for dividend on section 301(c)(1) portion, but not section 302(c)(2)-(3) portion (which is technically a Section 317(b) Redemption)

Dividend Exception: Report Recommendations

- **Actual Distributions:** The report recommends that the portion of a section 301(a) distribution to which section 301(c)(2)-(3) apply should not be defined as “economically similar” to a Section 317(b) Redemption
- In particular, the report argues that no portion of a distribution governed by section 301(a) bears relevant economic similarities to a Section 317(b) Redemption, nor implicates the policy concerns that prompted the enactment of the excise tax
 - A pro rata section 301(a) distribution does not reduce a shareholder’s proportionate interest in the distributing corporation
 - Part of broader “pro rata exclusion principle” in the report, which is a guiding principle that 100% pro rata redemptions/distributions generally should not be subject to the excise tax
- **Deemed Section 302(d) Distributions:** The report recommends that:
 - Section 302(d) redemptions that are 100% pro rata—whether or not the redemption is demonstrated to qualify under section 302(d) as to particular shareholders, and whether or not treated as out of E&P—should not be repurchases
 - For non-pro rata section 302(d) redemptions, guidance should clarify that the section 301(c)(2)-(3) portion of a distribution are repurchases

Other Topics

Netting Rule for Fiscal Year Taxpayers: Report Recommendations

- The excise tax applies “to repurchases . . . of stock after December 31, 2022”
- The netting rule reduces the repurchases taken into account under section 4501(a) “by the fair market value of any stock issued by the covered corporation during the taxable year” (emphasis added)
 - Based on the plain language, a taxpayer that has a non-calendar year as its taxable year may apparently, in the first fiscal year to which the excise tax applies (2022-2023), net all issuances during the fiscal year against repurchases during the 2023 portion of the fiscal year
 - It could be argued that taxpayers should not be able to offset gross issuances during the 2022 period of a fiscal year against repurchases during the 2023 period of a fiscal year
- The report notes that Treasury could consider a transition rule for 2022-2023 fiscal years
 - This rule could provide that a fiscal year taxpayer may only use net issuances (i.e., issuances net of redemptions) from the 2022 period for purposes of the netting rule
 - The report argues that, to the extent that Treasury issues this type of transition rule, it is important that notice of the rule be given prior to the excise tax’s effective date in order to avoid a retroactive change in the apparent statutory treatment of fiscal year taxpayers

Convertible Debt & Distressed Debt: Report Recommendations

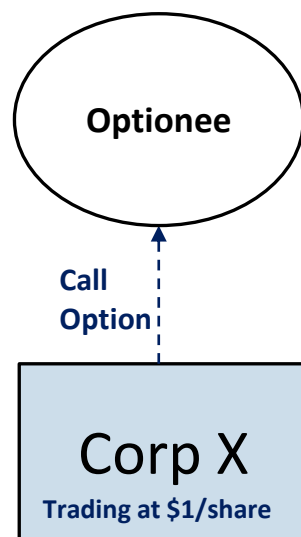
- **Convertible Debt:** Generally, convertible debt is a single debt instrument that also allows the holder to convert the instrument into a fixed amount of the issuer's stock
 - Assuming that the convertible debt is treated as indebtedness for federal income tax purposes, the retirement of a convertible debt instrument for cash is not a Section 317(b) Redemption
 - Thus, the excise tax could only apply to convertible debt redemptions if they are treated as “economically similar” to stock redemptions
 - The report recommends that a redemption of convertible debt generally not be defined as “economically similar” under section 4501(c)(1)(B)
- **Distressed Debt:** While a redemption of a covered corporation's instrument properly classified as debt is clearly outside the scope of the excise tax as a general matter, certain authorities have treated distressed debt as stock for purposes of other provisions of the Code
 - See *Helvering v. Ala. Asphaltic Limestone Co.*, 315 U.S. 179 (1942); Treas. Reg. 1.368-1(e)(6) (treating creditors as stockholders for purposes of the continuity of proprietary interest test)
 - The report recommends that a redemption of distressed debt generally not be defined as “economically similar” under section 4501(c)(1)(B)

Options Issued by Covered Corporations: Report Recommendations

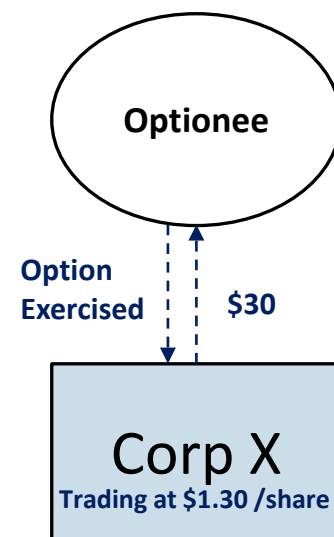
- A threshold question is whether a purchase of an option on a covered corporation's stock by that covered corporation (an "**Option Contract**") should be treated as a redemption of the underlying stock (i.e., as a repurchase subject to the excise tax)
- The report recommends that a purchase or issuance of an Option Contract by a covered corporation generally should not be treated as a redemption or issuance of the underlying stock
 - An Option Contract is economically distinct from stock because typically the Option Contract only provides for a measure of either upside or downside participation, and only does so for a limited period of time
 - Unlike stock, an Option Contract generally does not represent an ownership interest in the issuer because it does not convey voting rights or participation in dividends
 - The excise tax's drafting history demonstrates that Congress at one point considered, but ultimately rejected, the idea of the excise tax applying to Option Contracts in the same manner as stock. See Stock Buyback Accountability Act of 2021, S.2758, section 4501(c)(B)(i) (Sept. 20, 2021)

Selected Issues with Options: Net Cash Settlement of Call Option

Option Granted



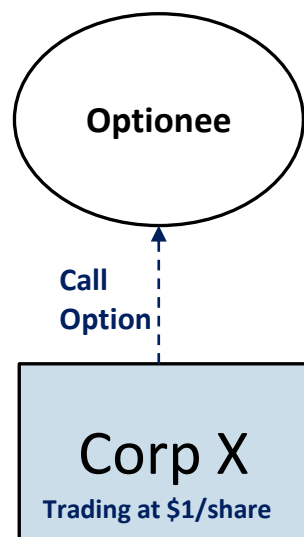
Option Exercised



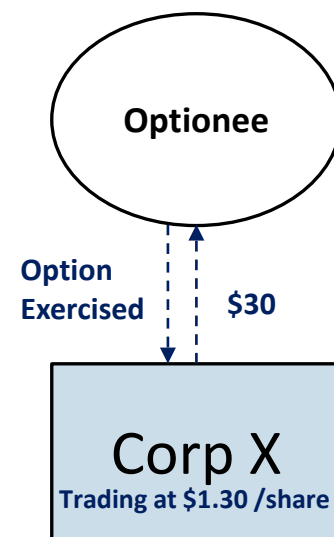
- Even if an Option Contract is not generally treated as stock for excise tax purposes, still a question of whether settling Option Contracts in certain circumstances should be subject to the Excise Tax and/or be an issuance for the netting rule
- **Example:** Corp X issues an option that entitles the option holder to purchase 100 shares of Corp X stock at a strike price of \$100 (\$1 per share) for a limited time
- Corp X shares trade at \$1 per share on the grant date, and the terms of the option allow net cash settlement. On the date that the option is exercised, Corp X stock trades at \$1.30 per share
- To settle the option, Corp X pays the holder \$30, the intrinsic value of the option
 - $(\$1.30 \text{ market price per share} - \$1 \text{ strike price per share}) * 100 \text{ shares} = \30
- This net cash payment of \$30 is equivalent in effect to the optionee paying \$100 to exercise the option; Corp X issuing 100 shares to the optionee; and Corp X immediately redeeming those 100 shares for \$130

Selected Issues with Options: Net Cash Settlement of Call Option

Option Granted

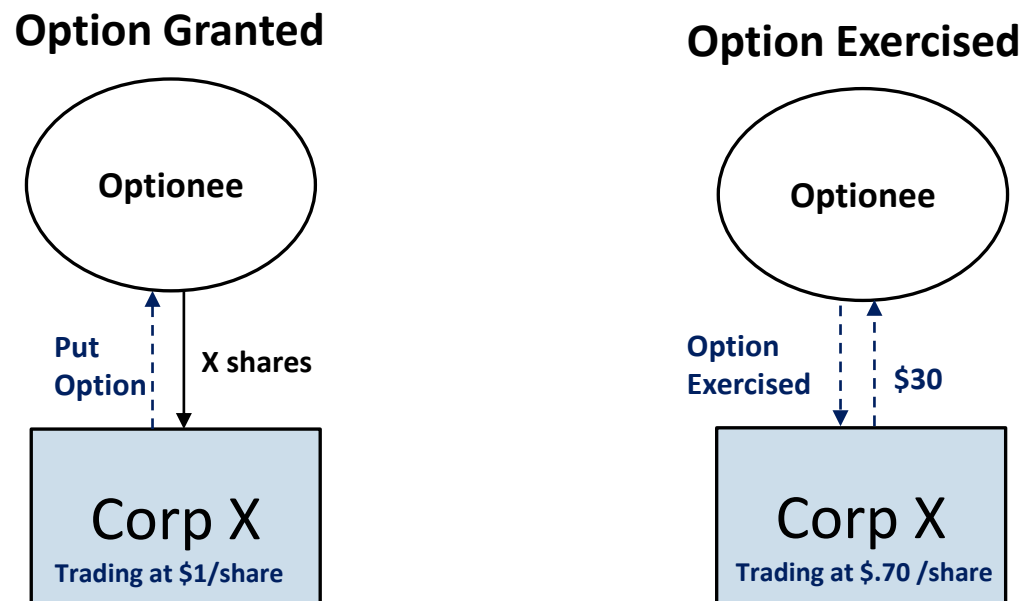


Option Exercised



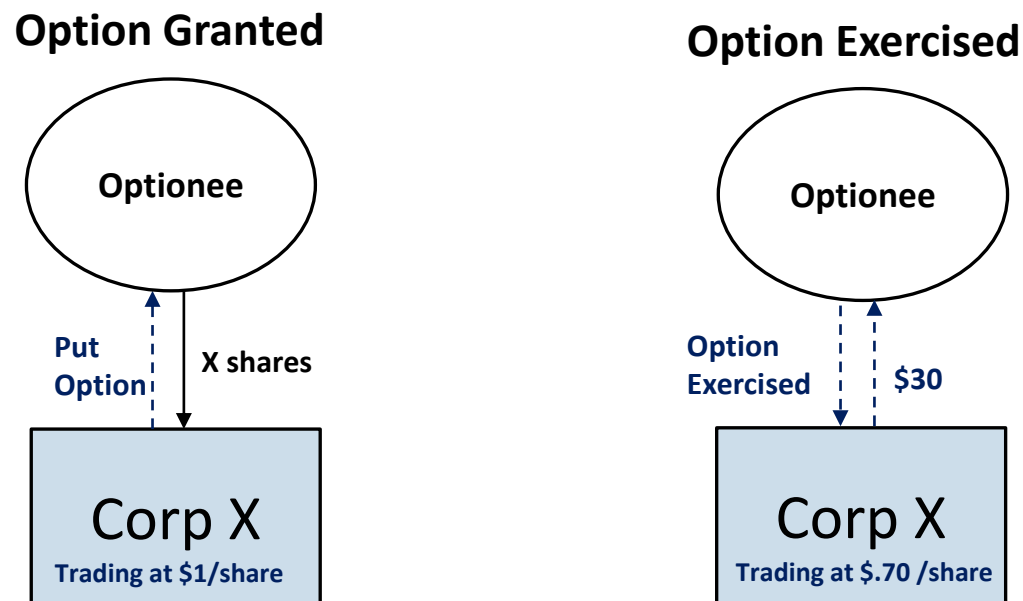
- **Original issuance of the Option:** Not a stock issuance for netting rule purposes under threshold recommendation for treatment of Option Contracts
- **Net Cash Settlement:** The report recommends that guidance should recognize both the deemed issuance of 100 shares and the deemed redemption of 100 shares of equal value that are reflected in this net settlement
 - Thus, the transaction should not result in excise tax liability because the \$130 deemed repurchase is netted to zero due to a simultaneous \$130 deemed issuance
- One could argue that the example above should produce a net redemption of \$30, given that the holder only “contributed” value of \$100 and extracted value of \$130 from the corporation. But the netting rule is based on “the fair market value of any stock issued by the covered corporation during the taxable year.” Section 4501(c)(3) (emphasis added)

Selected Issues with Options: Net Cash Settlement of Put Option



- Corp X issues an option that entitles the option holder to sell 100 shares of Corp X stock at a strike price of \$100 (\$1 per share) to Corp X for a limited time
- Corp X stock is trading at \$1 per share on the grant date, and the terms of the option allow for net settlement
- On the date that the option is exercised, Corp X stock is trading at \$0.70 per share. To settle the option, Corp X pays the option holder \$30
 - $(\$1 \text{ strike price per share} - \$0.70 \text{ market price per share}) * 100 \text{ shares} = \30

Selected Issues with Options: Net Cash Settlement of Put Option



- The report recommends that the \$30 that Corp X pays in the net cash settlement of the put option—i.e., the excess of the strike price over the fair market value of the referenced stock—should not be a repurchase subject to the excise tax
 - This intrinsic value of the put option represents payment for property that is separate from the referenced stock
 - Same point that “fair market value” of the stock is the touchstone for measuring repurchases and issuances