NATIONAL ASSOCIATION OF Manufacturers

Chris Netram

Managing Vice President,
Tax and Domestic Economic Policy

March 20, 2023

Internal Revenue Service
CC:PA:LPD:PR (Notice 2023-2)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2023-2: *Initial Guidance Regarding the Application of the Excise Tax on Repurchases of Corporate Stock under Section 4501 of the Internal Revenue Code*

To whom it may concern:

The National Association of Manufacturers ("NAM") appreciates the opportunity to provide comment to the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") on Notice 2023-2,[1] which provides initial guidance regarding the application of the excise tax on repurchases of corporate stock enacted by the Inflation Reduction Act ("IRA").[2]

The NAM is the largest manufacturing trade association in the United States, representing manufacturers of all sizes and in all 50 states. Manufacturing is a capital-intensive industry, requiring significant investments for equipment purchases and research and development ("R&D"). Manufacturers often turn to the public capital markets to finance these pro-growth activities, which set the stage for economic expansion, innovation, and job creation. Thus, a vibrant public market that supports capital formation and long-term growth is critical to the sustained success of manufacturing in America.

Manufacturers' ability to attract shareholders and efficiently allocate shareholder capital are critical to the vibrancy of the public market—and corporate stock buybacks are important for both capital formation and capital allocation. These return-of-capital transactions allow excess capital to flow where it can most efficiently be used, creating value for shareholders and enabling companies throughout the economy to attract much-needed investment. When manufacturers have access to capital, the benefits to the U.S. economy are clear: manufacturing employs 13 million Americans, contributes $2.81 trillion to the economy annually, and accounts for 55% of private-sector R&D. Despite these significant advantages, policymakers and regulators in recent years have taken steps to penalize companies engaging in these commonplace transactions, including by imposing the new excise tax on share repurchases.

The NAM strongly opposed the inclusion of the stock buybacks excise tax in the IRA. In encouraging Congress not to adopt the then-proposed excise tax, the NAM said that it would "limit manufacturers'

---

[1] *Notice 2023-2: Initial Guidance Regarding the Application of the Excise Tax on Repurchases of Corporate Stock under Section 4501 of the Internal Revenue Code*. 2023-3 IRB 374 (17 January 2023). *Available at* https://www.irs.gov/pub/irs-irbs/irb23-03.pdf.

[2] *Inflation Reduction Act of 2022*. Pub.L. 117-169 (2022).

ability to efficiently deploy critical resources," ultimately leading to "sub-optimal investment decisions" and "disincentiviz[ing] investors from providing much-needed capital to the manufacturing sector."[3]

While we understand that Treasury is statutorily obligated to implement the new tax, manufacturers remain opposed to policies that penalize stock buybacks. As such, the NAM urges Treasury to support companies' ability to efficiently allocate capital by limiting the impact of the excise tax. Unfortunately, the initial guidance does the opposite. In addition to punishing buybacks, it would implicate a wide range of other legitimate corporate transactions. The NAM is concerned that the guidance targets these transactions, which Congress did not intend or authorize Treasury to subject to the buybacks excise tax.

Attempting to limit stock buybacks and other ordinary-course-of-business transactions will ultimately harm shareholders by introducing a new governmental thumb on the scale that distorts company decisions about capital allocation, corporate structure, business combinations, and more. The NAM respectfully encourages Treasury to reconsider its approach to the excise tax and to promulgate proposed regulations that fall more squarely within the limits of the authorizing statute. A more tailored approach is critical to ensuring that manufacturers can continue to operate efficiently and make important corporate governance decisions in the best interests of their businesses and their shareholders.

I. Treasury should rescind the *Per Se* Rule targeting non-buyback payments to foreign corporations and provide clear safe harbors from the Funding Rule.

Internal Revenue Code ("IRC") Section 4501(d), as added by the IRA, treats the acquisition of stock of a foreign corporation by its U.S. affiliates as a share repurchase subject to the excise tax.[4] Manufacturers are concerned by the expansive approach the guidance institutes with respect to this statutory requirement.

First, the guidance expands the definition of repurchases "by" a U.S. affiliate to include repurchases *by the foreign corporation* if those repurchases were "funded" "by any means" by the U.S. affiliate (the "Funding Rule").[5] The guidance justifies this expansion by targeting payments to the foreign corporation by the U.S. affiliate that were made "for a principal purpose of avoiding the stock repurchase excise tax."[6] But this overextension of the statutory text is just the first step: next, the guidance defines *any payments made by the U.S. affiliate* to the foreign corporation as a *per se* attempt to avoid the buybacks tax (the "*Per Se* Rule").[7] Under the *Per Se* Rule, any payments from a U.S. affiliate in the two years prior to a foreign corporation repurchasing its own stock would be deemed a stock buyback.

The practical effect of this interpretation is that virtually any payments made by a U.S. affiliate to a foreign corporation would be classified as a share repurchase "by" the U.S. affiliate and thus subject to the buybacks excise tax. There are no exceptions to either the Funding Rule or the *Per Se* Rule for regular payments that are completely unrelated to share repurchases. As a result, routine

---

[3] *See* NAM Letter on Proposed Share Repurchase Excise Tax (1 November 2021). *Available at* https://documents.nam.org/tax/nam_stock_buybacks_letter.pdf. *See also* NAM Comments on SEC Share Repurchase Disclosure Proposal (1 April 2022), *available at* https://documents.nam.org/tax/nam_buybacks_comments.pdf, expressing manufacturers' disappointment that the agency was seeking to "denigrate and discourage the common practice of stock buybacks."

[4] *See* IRC § 4501(d).

[5] Notice 2023-2, *supra* note 1, at 379.

[6] *Ibid.*

[7] *Ibid.*

business transactions such as royalty, licensing, and interest payments could be subject to the tax. This is a significant departure from the statute and could result in a substantial tax increase on globally engaged manufacturers for activity which is not actually a share repurchase and which Congress did not contemplate nor authorize being subject to the excise tax. The IRA only allows for direct purchases of a foreign corporation's stock by a U.S. affiliate to be classified as buybacks—not repurchases by the foreign corporation itself that may have been funded by payments from the U.S. affiliate, and *certainly* not ordinary course payments from the U.S. affiliate that happen to fall within two years of a share repurchase by the foreign corporation.

Payments from U.S. affiliates to related foreign corporations are extremely common. For example, many U.S. businesses make regular royalty payments to their foreign counterparts. Similarly, many affiliated businesses have intellectual property ("IP") licensing arrangements that necessitate regular licensing payments from the U.S. affiliate to the foreign entity. Alternatively, a foreign corporation might make an intra-group loan to a U.S.-based business, necessitating regular interest payments. Or the two entities might engage in arm's-length transactions wherein the U.S. affiliate makes direct payments for inventory, goods, or services to the foreign corporation.

These types of transactions are critical to the functioning of multinational businesses. Royalties, licensing, interest, and the like enable groups of operating companies to work seamlessly toward their common goals: delivering products to customers, bolstering employment and economic development, and increasing value for shareholders. It is also worth noting that payments may be required by transfer pricing rules to ensure that intercompany transactions reflect arm's-length pricing. Perhaps most importantly in the context of the excise tax guidance and forthcoming regulations, these payments are in no way related to a foreign corporation's decision to repurchase shares of stock, nor can all instances of these transactions be reasonably classified as being undertaken "for a principal purchase" of funding any such repurchases.

Nevertheless, the guidance would classify *all* payments from a U.S. affiliate to a foreign corporation as buyback activity by deeming them *per se* attempts to avoid the buybacks excise tax. Because the window for this misclassification is two years from the date of any buyback, U.S. businesses will be punished virtually any time a foreign affiliate repurchases its own shares. This represents a significant tax increase on activity that Congress never intended nor authorized to be subject to the excise tax.

The NAM respectfully encourages Treasury to rescind the *Per Se* Rule from the guidance and not to incorporate any similar test in its forthcoming regulations. The IRA establishes that the excise tax applies to purchases of a foreign corporation's stock by a U.S. affiliate; Treasury is not authorized to expand Section 4501(d) to cover royalty, interest, and licensing payments and other similar transactions. Rescinding the *Per Se* Rule would keep Treasury's implementation of the stock buybacks excise tax within the bounds of the IRA and avoid undue tax burdens on ordinary business transactions completely unrelated to share repurchases.

If anti-abuse protections are necessary with respect to Section 4501(d), a narrow application of the Funding Rule via a facts-and-circumstances test—rather than the *Per Se* Rule—would be sufficient to clarify whether a given payment was for the purpose of evading the excise tax. Additionally, the NAM respectfully encourages Treasury to adopt clear safe harbors from the Funding Rule in order to cover transactions that are clearly non-abusive. Effective safe harbors would ease the administration of the excise tax and ensure that ordinary, non-abusive transactions are not subject to an undue and unauthorized tax burden. Specifically, the NAM encourages Treasury to clarify that the following payments would not be classified as "for a principal purpose of avoiding the stock repurchase excise tax" under the Funding Rule:

1. **Ordinary-course, arm's-length payments**, including payments to purchase inventory, payments for services (including R&D), routine treasury functions (including cash pooling, liquidity management, currency translation, and hedging transactions), payments of interest and return of principal, royalties, and similar ordinary course payments that meet the arm's-length standard of Section 482;
2. **Funding to finance dividends by a foreign affiliate**, i.e., any dividends paid by a U.S. affiliate to a related foreign corporation that are less than the foreign entity's dividends to its shareholders;
3. **Dividends to foreign affiliates in treaty countries** where the treaty provides for a reduced or eliminated U.S. withholding tax on such dividends, in order to avoid violating the terms of double-tax treaties that limit the U.S. taxation of dividends to foreign shareholders; and
4. **Funding consistent with pre-excise tax practices**, including any dividends or other payments from a U.S. affiliate to a related foreign corporation that are similar to funding provided during a three-year lookback period prior to the enactment of the excise tax.

The NAM respectfully encourages Treasury to rescind the *Per Se* Rule, narrow the scope of the Funding Rule, and provide clear safe harbors to protect ordinary-course-of-business transactions in order to align the guidance (and the forthcoming regulations) more closely with Treasury's statutory mandate under the IRA.

II. Treasury should not misclassify business combinations and reorganizations as transactions "economically similar" to share repurchases.

The NAM is also concerned by the approach to business combinations and reorganizations embodied by the guidance. Business combinations like mergers, acquisitions, and split-offs play a critical role in the manufacturing industry by providing growth opportunities for companies; they also lead to significant business efficiencies, support capital formation, create jobs, and drive innovation. Critically, these transactions bear little resemblance to the share repurchase activity contemplated by the IRA.

IRC Section 4501(c)(1)(B), as added by the IRA, authorizes Treasury to identify transactions "economically similar" to share repurchases that would be subject to the new excise tax.[8] The guidance uses this authority to misclassify a wide range of corporate reorganizations as buyback activity. Specifically, Treasury has taken the position throughout the guidance that the act of shareholders exchanging their shares as part of a reorganization is economically identical to a traditional stock buyback. But that is simply not the case: while in a narrow sense it is true that some number of shares change hands, these exchanges take place in the larger context of the transaction or restructuring itself. In brief, these are administrative steps necessary to effectuate the transaction and ensure that shareholders continue to have a stake in the post-reorganization entity. They are *not* an economically-motived exchange that might be more akin to a share repurchase.

For example, share exchanges in the context of acquisitive reorganizations allow the target company's shareholders to continue to hold shares in the post-acquisition entity, as do share exchanges following a split-off transaction. Meanwhile, Section 368(a)(1)(E) reorganizations are for clerical changes to, for example, a corporation's name or place of incorporation, and Section 368(a)(1)(F) reorganizations are recapitalizations designed to restructure a company's debt and equity. The share exchanges in these transactions are administrative rather than economic in nature. Moreover, these transactions are tax-free if the underlying requirements are met.

The NAM is concerned that Treasury is defining the share exchanges in these transactions as "economically similar" to stock buybacks. There is no indication in either the statute or the legislative

[8] *See* IRC § 4501(c)(1)(B).

history that Treasury has the latitude to implement the tax so broadly and aggressively as to encompass run-of-the-mill corporate reorganizations. And Treasury has offered no justification for classifying these otherwise tax-free transactions as "economically similar" to stock buybacks.

The NAM respectfully encourages Treasury to reconsider the approach to business combinations and reorganizations described in the guidance and not to apply similar reasoning to these transactions in the forthcoming implementation regulations. Congress authorized Treasury to apply the excise tax to share repurchases and to economically similar transactions, not to impose a new tax on a laundry list of unrelated transactions. Treasury should rescind its overbroad guidance related to these transactions and avoid ensnaring such transactions in its forthcoming regulations.

III. Treasury should exclude repurchases of nonparticipating preferred stock from the excise tax.

IRC Section 4501(f)(2), as added by the IRA, authorizes Treasury to issue regulations that address the treatment of "special classes of stock and preferred stock" under the excise tax.[9] The NAM respectfully encourages Treasury to utilize this authority to exempt manufacturers' repurchases of nonparticipating preferred stock from the tax.

Nonparticipating preferred stock generally has redemption and liquidation rights that are not analogous to those associated with common stock. Its issuance is often associated with specific financing mechanisms, including mezzanine financing by public companies and as an alternative to certain debt financing by private companies (which often repurchase those shares upon IPO). Nonparticipating preferred stock often functions as a debt-like instrument, distinguishing its redemption from the repurchase of common shares; it also is often mandatorily redeemable. The Code recognizes this debt-like treatment in several places, including Section 351 and Section 1504.

As such, the NAM respectfully encourages Treasury to use its authority under Section 4501(f)(2) to exclude repurchases of nonparticipating preferred stock from the excise tax in order to preserve companies' ability to use the issuance and redemption of such shares for capital formation purposes. At a minimum, Treasury should exempt repurchases of nonparticipating preferred stock issued prior to the enactment of the excise tax given that the terms of its issuance would have been determined without regard to the new tax.

* * * *

Stock buybacks are an important tool that allow a company's management to efficiently allocate capital consistent with their fiduciary obligations to shareholders. Investors directly benefit from stock buybacks in the form of a return on investment; they also indirectly benefit even when not selling shares because companies perform better when they employ efficient capital management practices. The NAM is disappointed that policymakers have chosen to punish companies conducting these commonplace, legitimate, and economically efficient transactions.

The NAM is further disappointed that Treasury has taken an expansive approach to implementing the new excise tax. Applying the buybacks excise tax to ordinary-course-of-business payments between affiliates, as well as to share exchanges associated with business combinations and reorganizations, would drastically expand its reach beyond what Congress intended and authorized. The transactions targeted by the guidance are economically distinct from share repurchases, and Treasury lacks the authority to redefine the scope of the tax in such a dramatic fashion.

---

[9] *See* IRC § 4501(f)(2).

The NAM respectfully encourages Treasury to reconsider these damaging aspects of the guidance and to avoid imposing unnecessary and extra-statutory tax burdens on non-buyback transactions when it issues implementing regulations for the excise tax. Tailoring the implementation of such a misguided tax will ensure that it is minimally damaging to manufacturers and their efforts to invest for the future.

Sincerely,

Chris Netram
Managing Vice President, Tax and Domestic Economic Policy