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Frequently Asked Questions About the Stock Buyback Tax Under the Inflation Reduction Act of 2022

Background

The Inflation Reduction Act of 2022 adds a new Internal Revenue Code section, Section 4501,¹ that imposes a 1 percent excise tax on stock repurchases by publicly traded companies that occur after December 31, 2022. Specifically, under Section 4501, a covered corporation is subject to a tax equal to 1 percent of (1) the fair market value of any stock of the corporation that is repurchased by this corporation (or certain affiliates) during any taxable year, with limited exceptions, less (2) the fair market value of any stock issued by the covered corporation (or certain affiliates) during the taxable year (including compensatory stock issuances). The 1 percent excise tax may also be imposed on acquisitions of stock in certain mergers or acquisitions involving covered corporations.

Because the tax is not based on a measure of income, the excise tax is not an income tax and, therefore, is not within the scope of ASC 740.² The accounting for taxes paid in connection with the repurchase of stock is not specifically addressed in U.S. GAAP. However, AICPA Technical Q&As Section 4110.09³ indicates that direct and incremental legal and accounting costs associated with the acquisition of treasury stock may be added to the cost of the treasury stock. Therefore, it is acceptable to account for the Section 4501 excise tax obligation that results from the repurchase of common stock classified within permanent equity as a cost of the treasury stock transaction. Any reductions in the excise tax obligation associated with share issuances would also be recognized as part of the original treasury stock

¹ Internal Revenue Code Section 4501, "Repurchase of Corporate Stock."

² For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

³ AICPA Technical Questions and Answers Section 4110.09, "Costs Incurred to Acquire Treasury Stock."

transaction even if the share issuance is a different type of instrument than the share that was repurchased.

Additional considerations are necessary when the excise tax obligation is related to redemptions of preferred stock. Such an excise tax obligation would be recognized as a cost of redeeming the preferred stock. The accounting for redemptions of preferred stock differs depending on the classification of the preferred stock as permanent equity, temporary equity, or a liability. An entity would need to use a systematic and rational allocation approach to account for the effect of share issuances on the excise tax obligation when the entity has repurchases of both common stock and preferred stock during a taxable period.

This publication addresses some frequently asked questions related to the Section 4501 excise tax but does not discuss any legal interpretations associated with this tax. Note that in this publication, it is assumed that any common stock subject to the excise tax is classified in permanent equity.

Questions and Answers

General

Question 1

Is an entity required to estimate future stock repurchases and stock issuances in measuring its excise tax obligation during an interim financial reporting period?

Answer

No. Because the excise tax is imposed annually, the calculation of the amount owed for a taxable year is only determined at the end of the annual period for which the tax is payable. For interim periods, an entity is not required to estimate future stock repurchases and stock issuances to measure its excise tax obligation. Rather, an entity can generally record the obligation on an as-incurred basis.⁴ In other words, the excise tax obligation recognized at the end of a quarterly financial reporting period is calculated as if the end of the quarterly period was the end of the annual period for which the excise tax obligation is payable. Although the excise tax is not within the scope of ASC 740, this approach is similar to the accounting for items separately from the determination of the estimated annual effective tax rate (i.e., discrete items).

Example

Entity A, a calendar-year entity, repurchases common stock with a fair value of \$100 million on February 1, 20X2. Entity A also expects to issue \$40 million of common stock during the remaining fiscal year but has not issued any such stock as of March 31, 20X2. For the interim period ended March 31, 20X2, A would record the following journal entry for the excise tax:

Treasury stock/additional paid-in capital (APIC)	1,000,000	
Excise tax payable		1,000,000

Although A expects to have net repurchases of \$60 million in stock during the fiscal year and therefore expects to be obligated to pay an excise tax of \$600,000 for the year ended December 31, 20X2, for the three months ended March 31, 20X2, A has only repurchased common stock that has a fair value of \$100 million. Therefore, as of March 31, 20X2, A recognizes the \$1 million tax that would be payable if A only repurchased \$100 million of common stock (i.e., \$100 million \times 0.01 = \$1 million).

⁴ See [Questions 3](#) and [4](#) for the accounting for certain preferred stock instruments.

Example (continued)

Note that although an entity is not required to recognize an excise tax obligation in interim periods by using an approach based on the estimated annual excise tax payable, such recognition is not precluded provided that the amount of tax obligation recorded as of any balance sheet date does not exceed the amount that would be payable if the balance sheet date was the end of the taxable year.⁵ Such an alternative approach may be consistent with the estimated annual effective tax rate method that is used to calculate income taxes on an interim basis under ASC 740. Given the facts above, for the interim period ended March 31, 20X2, A would record the following journal entry for the excise tax if it used this alternative approach:

Treasury stock/APIC	600,000	
Excise tax payable		600,000

The approach an entity uses to recognize an excise tax obligation during an interim reporting period is an accounting policy election that must be consistently applied and disclosed, if material.

Question 2

How should an entity account for an excise tax obligation associated with the repurchase of preferred stock that is classified in permanent equity?

Answer

The excise tax should be included in the charge (credit) to retained earnings that is recognized for the redemption of the preferred stock in accordance with ASC 260-10-S99-2. This charge (credit) is accounted for as a dividend that adjusts the numerator in the calculation of basic earnings per share. The obligation for the excise tax should be recognized on the repurchase date. See [Section 3.2.2.6](#) of Deloitte's Roadmap *Earnings per Share* for more information about the redemption of preferred stock.

Question 3

How should an entity account for an excise tax obligation associated with the repurchase of preferred stock that is classified in temporary equity?

Answer

If the preferred stock is being remeasured to its redemption amount under ASC 480-10-S99-3A(13)–(16), the entity should consider the probability of redeeming the instrument.⁶ If it is probable that the preferred stock instrument will be redeemed, it is appropriate to include the future excise tax obligation in the periodic remeasurement of the instrument to its redemption amount. Any adjustment to the excise tax obligation on actual redemption of the preferred stock would be recognized as a charge (credit) to retained earnings in accordance with ASC 480-10-S99-3A and ASC 260-10-S99-2. See [Chapter 9](#) of Deloitte's Roadmap *Distinguishing Liabilities From Equity* for more information about applying the SEC's guidance on temporary equity.

If the preferred stock is not being remeasured to its redemption amount under ASC 480-10-S99-3A(13)–(16), or it is not probable that the instrument will be redeemed, the entity should account for the excise tax in the same manner as it would account for an excise tax on the redemption of preferred stock that is not classified in temporary equity. (See [Question 2](#).)

⁵ However, because of the complexities of this approach, we would not expect it to be widely used in practice.

⁶ Note that this assessment differs from the requirement in ASC 480-10-S99-3A to assess whether it is probable that the preferred stock instrument will become redeemable.

Question 4

How should an entity account for an excise tax obligation associated with the repurchase of liability-classified preferred stock?

Answer

Preferred stock that is a mandatorily redeemable financial instrument under ASC 480-10-25-4 must be classified as a liability. Because it is certain on issuance of such an instrument that it will be redeemed, if the redemption of the instrument gives rise to an excise tax obligation, that obligation may be considered to have been incurred on the issuance date. However, if the redemption was to occur during an annual period in which there are stock issuances, the entity could owe no excise tax as a result of the redemption of the liability-classified preferred stock instrument. Furthermore, the amount of any tax owed could change on the basis of the change in the fair value of the liability-classified preferred stock instrument. For these reasons, there may be diversity in the accounting for an excise tax obligation associated with the repurchase of liability-classified preferred stock.

Approaches that may be applied in practice to account for an excise tax obligation associated with the redemption of liability-classified preferred stock may include:

- *View A* — Recognize the excise tax obligation on the date the instrument is issued, with an offsetting discount on the preferred stock. This discount would be amortized to interest cost over the life of the instrument in accordance with the interest method in ASC 835-30.
- *View B* — Recognize the excise tax obligation over the life of the instrument in accordance with the interest method in ASC 835-30. This approach differs from View A only with respect to the timing of when the obligation is recognized.
- *View C* — Recognize the excise tax obligation on the date the instrument is redeemed. The excise tax would be included in the gain or loss on extinguishment of the instrument. The excise tax amount may be affected by stock issuances during the period the instrument is redeemed.

Because the accounting for an excise tax obligation that is incurred on the redemption of a liability-classified preferred stock instrument is not specifically addressed in U.S. GAAP, any of the above three approaches may be acceptable depending on the facts and circumstances.

Question 5

How should an entity account for an excise tax obligation associated with the repurchase of a share-based payment award?

Answer

If the share-based payment award was classified as an equity instrument before the repurchase and no additional compensation cost is recognized from the repurchase, the excise tax would be recognized in equity as part of the repurchase transaction.⁷ If, however, additional compensation cost is recognized as a result of the repurchase, a portion of the excise tax, if any, that is allocable to the additional compensation cost should be recognized in earnings.

If the share-based payment award was classified as a liability instrument, the excise tax should be recognized in earnings as part of the extinguishment of the liability.

⁷ If the instrument is preferred stock, see [Questions 2 and 3](#).

Allocating Offsetting Credits for Stock Issuances

Question 6

How should an entity account for reductions in the excise tax obligation that result from stock issuance transactions?

Answer

An entity should record the reduction in the tax obligation as a decrease to the “debit” entry that was recognized from the original repurchase transaction that gave rise to the excise tax obligation. It is not acceptable to record the reduction in the tax obligation on the basis of the nature of the stock issuance transaction that gives rise to the credit to the overall tax obligation. Such an approach could result in net credits to income as a result of the excise tax, which is not appropriate (see [Example 1](#)).

Note that the accounting for reductions in an excise tax obligation that arise from stock issuances could be complex. This is especially the case if an entity has multiple repurchases and issuances during an annual reporting period. Therefore, an entity is required to use a systematic and rational allocation approach to account for the effect of share issuances on the excise tax obligation when an entity has repurchases of common stock, preferred stock (whether classified in permanent equity, temporary equity, or as a liability), and share-based payment awards during a taxable period.

Example 1

Entity B repurchases \$1 billion in common stock, which results in an excise tax obligation of \$10 million. This excise tax is recorded in equity as follows:

Treasury stock/APIC	10,000,000	
Excise tax liability		10,000,000

Later in the same taxable year, B grants fully vested common stock to employees that has a fair value of \$100 million, resulting in a \$1 million reduction in the excise tax amount due. The compensation cost for these shares is expensed as incurred.

Entity B would record the following journal entry to account for the impact of the stock issuance on the excise tax amount due:

Excise tax payable	1,000,000	
Treasury stock/APIC		1,000,000

If B had associated the excise tax reduction from the stock issuance with the transaction that gave rise to this decrease, it would have recognized a \$1 million credit to compensation expense. Such recognition would not be acceptable. Rather, the net excise tax amount due of \$9 million should be recognized as a debit to treasury stock/APIC.

Example 2

Entity C has the following transactions that are subject to the Section 4501 excise tax:

- Repurchase of \$2 billion of common stock.
- Repurchase of \$1 billion of equity-classified preferred stock.
- Issuance of \$500 million of common stock as part of a share-based payment arrangement.

Example 2 (continued)

Entity C has determined that a pro rata allocation of the reduction in the total excise tax arising from the issuance of common stock would represent a systematic and rational accounting method. Therefore, C allocates the \$5 million benefit (i.e., \$500 million \times 0.01 = \$5 million) from the issuance of common stock as follows:

Common stock	\$3,333,333 (\$5 million \times [\$2 billion \div \$3 billion])
Preferred stock	\$1,666,667 (\$5 million \times [\$1 billion \div \$3 billion])

Note that if C originally reported a reduction to retained earnings of \$10,000,000 (\$1 billion \times 0.01 = \$10 million) as a result of the repurchase of the preferred stock, it would later record a credit to retained earnings of \$1,666,667 in such a way that a net amount of \$8,333,333 would be reflected as a reduction to income available to common stockholders in the annual calculation of basic earnings per share.

Statement of Cash Flows

Question 7

How should an entity classify cash paid for excise taxes in its statement of cash flows?

Answer

ASC 230 does not specifically address the classification of cash outflows for payment of the excise tax. Therefore, either of the following two classifications is acceptable:

- Net cash paid for excise taxes is reported in **operating activities**. This classification is consistent with ASC 230-10-45-17(c), which indicates that “[c]ash payments to governments for taxes, duties, fines, and other fees or penalties” are cash outflows for operating activities.
- Net cash paid for excise taxes is reported in **financing activities**. This classification is consistent with ASC 230-10-45-15(a), which states that cash outflows for financing activities include:

Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by a grantor when withholding shares from a grantee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.

An entity should elect one of the two approaches as an accounting policy and report the net cash paid for excise taxes in either operating or financing activities. An entity is not permitted to report amounts in both operating activities and financing activities.

Note that only actual cash payments for excise taxes will affect an entity's statement of cash flows. If an entity has recognized an excise tax payable, it should report that transaction as a noncash financing activity if it elects to report cash amounts paid within financing activities.

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