HOT TOPIC

Share repurchase tax

New excise tax on repurchases of an entity's own shares

August 2023

KPMG answers questions about the 1% excise tax on annual net repurchases of certain publicly traded companies' own shares.

The Inflation Reduction Act of 2022 (IRA) was signed into law in August 2022.[1] Among other things, it imposes a 1% excise tax on net share repurchases in a tax year that are made by certain publicly traded corporations. The tax applies to repurchases of common and preferred shares, net of issuances (including exercises of options or vesting of restricted shares) in a tax year. The tax is based on the fair market value of repurchased shares on the repurchase date. This new tax is effective in 2023 for calendar year-end publicly traded companies to which it applies.

The excise tax is not accounted for as an income tax under Topic 740. Instead, companies will generally account for the excise tax as a direct cost of a share repurchase transaction. The following table summarizes considerations for determining the appropriate accounting treatment.

Consideration	Summary of impact	See
Initial recognition and subsequent adjustment	It is appropriate to recognize these direct costs in the period(s) that includes a repurchase and subsequently adjust those costs for any reductions in the period that includes a share issuance. When the related charges for excise taxes affect multiple classes of common shares or preferred shares, companies should select a reasonable and consistent policy for allocating subsequent reductions to the cost for share issuances.	Questions 10 to 30
Repurchased share's balance sheet classification	Repurchase accounting depends on the repurchased share's balance sheet classification – i.e. permanent equity (common shares and preferred shares), temporary equity or liability.	Questions 40 to 70
Cash flow presentation	It is appropriate to classify the excise tax paid in line with the nature of the transaction.	Question 80

1 In IRS Notice 2023-2, the IRS provides initial guidance on application of the excise tax, including the companies to which it applies and how the tax is determined. For practical considerations for retirement plans and equity-based compensation arrangements, see KPMG report, IRA stock buyback.

Questions and answers

The questions and answers below reflect issues encountered in practice since the IRA was signed into law. The guidance reflects how we believe companies should account for the excise tax under US GAAP; other alternatives may be acceptable in some situations. We will continue to update our views if and when additional information becomes available.

Question 10
Is the excise tax a direct and incremental cost of a share repurchase transaction?

Interpretive response: Yes. The excise tax is determined on a non-income-based measure and is therefore not accounted for as an income tax under Topic 740. In the absence of explicit guidance for taxes that are not subject to Topic 740, we believe companies will generally account for the excise tax as a direct and incremental cost of repurchasing shares, similar to treatment of other transactional taxes such as sales taxes or value-added taxes.

The accounting for a direct and incremental cost of a repurchase transaction depends on the balance sheet classification of the share that was repurchased; see Question 40 (permanent equity), Question 50 (temporary equity) and Question 60 (liability).

Question 20
When is the excise tax recognized?

Interpretive response: The excise tax (as a direct cost – see Question 10) is recognized as an obligation when shares are repurchased. The recognized amount is subsequently adjusted for any reductions when shares are issued (including exercises of options or vesting of restricted shares). An entity does not recognize an asset for net share issuances at a reporting date because that future benefit can only be realized if future repurchases equal or exceed total issuances in the same tax year.

Question 30
How is an adjustment to the excise tax obligation recognized when multiple classes of common shares or preferred shares are repurchased in a tax year?

Interpretive response: When an entity repurchases multiple classes of common shares or preferred shares in a tax year, it records the related excise tax obligation as a cost of those repurchases (see Question 20) and that cost affects pretax income or equity based on how the shares are classified (see Questions 40-60). When an adjustment to the total excise tax obligation is needed due to issuances (see Question 20) and multiple classes have been repurchased, we believe a company should select a reasonable policy for allocating the adjustment to the shares repurchased.

We believe the following methods are acceptable; there may be other acceptable approaches. The selection of a method represents an accounting policy, which is applied consistently and disclosed in the financial statements.

Method 1	Allocate the adjustments pro rata based on the proportion of excise tax recognized in pretax income and equity, if applicable.
Method 2	Allocate the adjustments first to the first repurchase of the tax year, next to the second repurchase, and so on.

Question 40
How does an entity account for excise tax on repurchases of shares classified in permanent equity?

Interpretive response: It depends on whether the shares are common or preferred shares, as summarized in the following table.

Type of share	Accounting treatment
Common shares	When an issuer repurchases its own permanent equity-classified common shares, the shares are referred to as 'treasury shares' and are accounted for under Subtopic 505-30. The cost of treasury shares – including excise taxes as a direct and incremental cost of their acquisition – is recorded as a reduction of shareholder's equity. In our experience, treasury shares are typically presented as a separate caption in equity unless the repurchased shares are immediately retired. See also KPMG Handbook, Debt and equity financing, Questions 5.8.10 and 5.8.20.
Preferred shares	The treasury shares guidance in Subtopic 505-30 applies only to transactions involving common shares. Instead of applying that guidance, an issuer accounts for a repurchase of its own permanent equity-classified preferred shares by recording any difference between the amount paid for the repurchase and the preferred shares' carrying amount in retained earnings as a deemed dividend (or contribution). The excise tax – as a cost of the repurchase transaction – is included in the amount paid for the repurchase when determining that difference and, therefore, affects deemed dividends (contributions). This is the same treatment as for preferred shares classified in temporary equity (see Question 50. See also KPMG Handbook, Debt and equity financing, Questions 5.8.05 and 5.4.35.

Example 10
Repurchase of common shares classified in permanent equity (treasury shares)

On January 1, Year 1, Issuer issues 100,000 common shares with a par value of $1 for $10 per share. Issuer records the following journal entry.

$'000s	*Debit*	*Credit*
Cash	1,000	
Common shares – par value[1]		100
APIC[2]		900
To recognize issuance of common shares.		

Notes:
1. $1 par value per share × 100,000 shares issued
2. Excess of proceeds from issuance of shares ($1,000,000) – par value of shares issued ($100,000)

Issuer does not subsequently remeasure the shares.

On December 31, Year 2, Issuer repurchases 20,000 of its common shares for $15 per share. The shares are held as treasury shares (i.e. the shares are not retired). Issuer records the transaction through the following journal entry.

$'000s	*Debit*	*Credit*
Treasury shares	303	
Cash		300
Excise tax liability[1]		3
To recognize repurchase of common shares and corresponding excise tax liability.		

Note:
1. $300,000 repurchase price × 1% excise tax

Question 50
How is an excise tax obligation associated with the repurchase of temporary equity-classified preferred or common shares accounted for?

Background: The SEC requires equity instruments to be classified outside of permanent equity (often referred to as being classified in 'temporary equity') if they include redemption features that may be triggered by events that are not solely in the issuer's control and that the issuer has to settle in cash or other assets. Entities subject to the SEC's temporary equity guidance include SEC registrants (e.g. public companies that prepare their financial statements under Regulation S-X) and other companies that comply with SEC rules and regulations (e.g. certain depository and lending institutions). Entities that are not required to apply the temporary equity guidance may nonetheless do so. For entities subject to, or that elect to apply temporary equity guidance, see KPMG Handbook, Debt and equity financing, chapter 7.

Interpretive response: If preferred or common shares are temporary equity-classified, the issuer accounts for their repurchase by recording any difference between the amount paid for the repurchase and the shares' carrying amount in retained earnings as a deemed dividend (or contribution). The excise tax – as a direct cost of the repurchase – is included in the amount paid for the repurchase when determining that difference. Therefore, recognition of the excise tax obligation affects deemed dividends.

See also KPMG Handbook, Debt and equity financing, section 7.4.70 and Question 5.4.35.

Example 20
Repurchase of preferred shares classified in temporary equity

On January 1, Year 1, Issuer (an SEC registrant) issues preferred shares for $50 million of proceeds. The preferred shares are redeemable at fair value for cash at any date at the holders' option. No features require bifurcation and there are no other instruments issued in conjunction with the preferred shares that would require an allocation of the initial proceeds.

Because the preferred shares are redeemable at any date at the holders' option, they are classified as temporary equity. Further, they will be currently redeemable at each reporting date and, as a result, Issuer will subsequently measure them by adjusting their carrying amount to equal the maximum redemption value at each reporting date (including amounts representing dividends not currently declared or paid, but which will be payable under the redemption features or for which payment is not solely in Issuer's control).

Issuer records the following journal entry on January 1, Year 1.

$'000s	*Debit*	*Credit*
Cash	50,000	
Temporary equity (preferred shares)		50,000
To recognize issuance of the preferred shares.		

On December 31, Year 1, the fair value of the preferred shares is $55 million. Issuer has retained earnings and there are no specific legal requirements for recording adjustments. Issuer records the following journal entry.

$'000s	*Debit*	*Credit*
Equity – Retained earnings	5,000	
Temporary equity (preferred shares)[1]		5,000
To recognize subsequent measurement of the preferred shares.		
Note:		
1. $55 million maximum redemption amount at reporting date − $50 million carrying amount		

On December 31, Year 2, the holders exercise their right to redeem the preferred shares at current fair value of $60 million for cash. Issuer had no issuances of shares during Year 2. Issuer has retained earnings and there are no specific legal requirements for recording the redemption. Issuer records the following journal entries.

$'000s	*Debit*	*Credit*
Equity – Retained earnings	5,000	
Temporary equity (preferred shares)[1]		5,000
To recognize subsequent measurement of the preferred shares immediately before redemption.		
Temporary equity (preferred shares)	60,000	
Equity – Retained earnings[2]	600	
Cash		60,000
Excise tax liability[2]		600
To recognize redemption of preferred shares and related excise tax liability.		

Notes:

1. $60 million maximum redemption amount − $55 million carrying amount
2. $60 million repurchase price × 1% excise tax

Increases in the carrying amount of temporary equity-classified instruments resulting from their subsequent measurement and the difference between their repurchase price and carrying amount are not recognized in net income. Instead, they are treated in the same manner as dividends on nonredeemable shares (i.e. deemed dividends) and are effected by charges against retained earnings. See chapter 3 of KPMG Handbook, Earnings per share.

Excise tax is recognized as a deemed dividend (contribution) in some situations (see **Questions 40** and **50**). A deemed dividend generally reduces net income available to common shareholders when computing EPS, even though it does not affect earnings. However, the effect on EPS will vary depending on whether the share is a common share and, if so, on whether it is redeemable at fair value (or an amount other than fair value).[2]

Question 60

How is an excise tax obligation associated with the repurchase of liability-classified shares accounted for?

Background: Under Topic 480 (distinguishing liabilities from equity), shares that are equity in legal form are sometimes classified as liabilities. For example, this is the case (with some exceptions) with a mandatorily redeemable share – i.e. one that the issuer must redeem by transferring its assets at a

[2] See sections 3.3 and 5.3 of KPMG Handbook, Earnings per share, and section 7.4 of KPMG Handbook, Debt & equity financing.

specified or determinable date(s) or upon an event that is certain to occur. See chapter 6 of KPMG Handbook, Debt & equity financing.

Interpretive response: Any difference between the reacquisition price of extinguished liability-classified shares (i.e. debt) and their net carrying amount is recognized as an extinguishment gain or loss. The excise tax – as a direct cost of the repurchase – is included in the reacquisition price when determining that difference. Therefore, recognition of the excise tax obligation affects earnings.

Example 30
Repurchase of mandatorily redeemable shares classified as a liability

On January 1, Year 1, Issuer issues preferred shares for issuance proceeds of $15 million. Issuer must redeem the shares for $20 million cash on December 31, Year 3; therefore, the preferred shares are mandatorily redeemable and are liability-classified.

$'000s	*Debit*	*Credit*
Cash	15,000	
Mandatorily redeemable preferred shares liability		15,000
To recognize issuance of mandatorily redeemable preferred shares.		

Between January 1, Year 1 and December 31, Year 3, the carrying amount was accreted to the redemption amount of $20 million using the effective interest method. On December 31, Year 3, Issuer redeems the preferred shares for cash. Issuer had no issuances of shares during Year 3.

Issuer records the following journal entry to record the redemption of the preferred shares on December 31, Year 3.

$'000s	*Debit*	*Credit*
Mandatorily redeemable preferred shares liability	20,000	
Loss on extinguishment	200	
Cash		20,000
Excise tax liability[1]		200
To recognize redemption of mandatorily redeemable preferred shares and related excise tax obligation.		
Note:		
1. $20 million repurchase price × 1% excise tax		

Question 70

Is the excise tax on repurchases of equity classified common shares from an employee accounted for similar to other repurchases if the repurchase price is in excess of the shares' fair value?

Interpretive response: Yes. An entity generally accounts for excise tax on repurchase of equity classified common shares similar to other repurchases. This is the case even if the common shares are repurchased for more than their fair value.

When the repurchase price (i.e. cash or other assets paid, or liabilities assumed) exceeds fair value, the excess purchase price represents compensation for prior services under Topic 718. However, the excise tax is based on the fair value of repurchased shares instead of the repurchase price. Therefore, we believe it is acceptable to recognize the excise tax in equity, similar to other repurchases of equity classified common shares. See Question 30.

Question 80

How is excise tax paid on share repurchases classified in the statement of cash flows?

Interpretive response: Topic 230 does not specify the appropriate cash flow classification for excise tax paid; therefore, judgment is required, taking into consideration relevant facts and circumstances. We believe it is generally appropriate to classify excise tax paid on share repurchases in line with the nature of the transaction, as follows.

Excise tax paid for repurchase of:	Accounting treatment	Cash flow classification
Equity classified shares (see Questions 40, 50 and 70)	Affects equity	**Financing** activities. This is consistent with the classification of outlays to reacquire the entity's equity instruments (see Question 19.3.30 in KPMG Handbook, Statement of cash flows).
Liability-classified shares (see Question 60)	Affects pretax income	**Financing** activities. This is consistent with the classification of debt extinguishment costs (see Question 12.3.50 in KPMG Handbook, Statement of cash flows).

The excise tax for the current tax year is paid in the following year. Because of this timing mismatch, there are some additional issues to consider, as follows.

- It may be necessary to present all or some of the excise tax accrued that affects pretax income in the period as a reconciling noncash item in the reconciliation of net income to net cash flows from operating activities.
- There may be noncash financing activities to disclose – e.g. the amount of excise tax charged to equity that is not paid in the period.

See KPMG Handbook, Statement of cash flows.

Contact us

Matt Drucker
Partner
mdrucker@kpmg.com

Mahesh Narayanasami
Partner
maheshnarayanasami@kpmg.com

Lisa Blackburn
Partner
lisablackburn@kpmg.com

Valerie Boissou
Partner
vlesageboissou@kpmg.com

Nick Burgmeier
Partner
nburgmeier@kpmg.com

kpmg.com/socialmedia