Snapshot

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Accounting for excise tax on repurchases of stock

Among other things, the Inflation Reduction Act of 2022 imposes a 1 percent excise tax on “net repurchases” (that is, certain purchases minus certain issuances) of corporate stock made within a tax year beginning after December 31, 2022. The IRS and Treasury Department recently released Notice 2023-2 to provide initial guidance on implementing the new excise tax.

Accounting for the excise tax

Scope

Since the excise tax is not based on income, it is not within the scope of ASC 740, *Income Taxes*. U.S. GAAP does not include explicit guidance on accounting for taxes that are not considered taxes on income. We believe that the excise tax should be included in the cost of the repurchase of the corporate stock transaction. As a result, the balance-sheet classification of the corporate stock prior to it being repurchased governs the accounting for the excise tax.

U.S. GAAP requires entities to classify issued and outstanding corporate stock on the balance sheet in one of three ways:

- As permanent equity;
- As temporary equity; or
- As a liability.

Permanent equity

According to SEC Staff Accounting Bulletin (SAB) Topic 5.A, which is codified in the guidance on other assets and deferred costs in ASC 340-10-S99-1, specific incremental costs directly attributable to a securities offering may be deferred and charged against the gross proceeds of the offering in equity. This guidance can be applied by analogy to treasury stock transactions, as noted in AICPA Technical Questions and Answers 4110.09, which states that costs associated with the acquisition of treasury stock may be added to the cost of the treasury stock. As such, the excise tax would be recorded as an incremental cost to repurchase the treasury shares, with an offsetting tax liability recognized.

Temporary equity

Accounting for an excise tax incurred to repurchase corporate stock that is classified as temporary equity would follow the same guidance used to account for an excise tax incurred to repurchase corporate stock that is classified as permanent equity. In other words, the excise tax would be considered in the cost of the repurchased stock recognized in equity.

Liability

The repurchase of liability-classified corporate stock should be accounted for using the guidance on extinguishing a liability in ASC 405, *Liabilities*.

Any costs associated with the extinguishment of a liability through a repurchase transaction would be a component of the gain or loss realized upon extinguishing the liability and recognized in the income statement.

Timing of recognition of excise tax

Excise tax should be recognized in the period incurred (that is, when the repurchase occurs). Any reduction in the tax liability due to a subsequent stock issuance, or an event giving rise to an exception, that occurs within a tax year should be recorded in the period of such stock issuance or event giving rise to an exception.

Any reduction in the previously recognized excise tax liability due to issuances or events giving rise to exceptions should be recognized through the same line item affected by initially recognizing the excise tax liability. For example, if the excise tax was initially recognized as part of the cost basis of treasury stock, any reduction to the excise tax liability should be recognized through an adjustment to the treasury stock's carrying value rather than in the income statement.

If multiple different repurchases and issuances have occurred and the excise tax has been recorded both in equity and the income statement, an entity should allocate the reduction of the excise tax liability between equity and the income statement upon issuing the stock using a reasonable allocation method. The allocation method selected should be applied consistently and should be disclosed if material.

Net stock issuances

If stock issuances within the same tax year exceed stock repurchases (that is, a "net stock issuance" has occurred), an entity should not recognize an excise tax asset, since realizing such an asset depends on future stock repurchases within the same tax year. Therefore, until a subsequent stock repurchase occurs, an asset should not be recognized.

For more information about the excise tax and the initial guidance from the IRS and Treasury Department, see "Key questions answered on stock buyback tax" on grantthornton.com.

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