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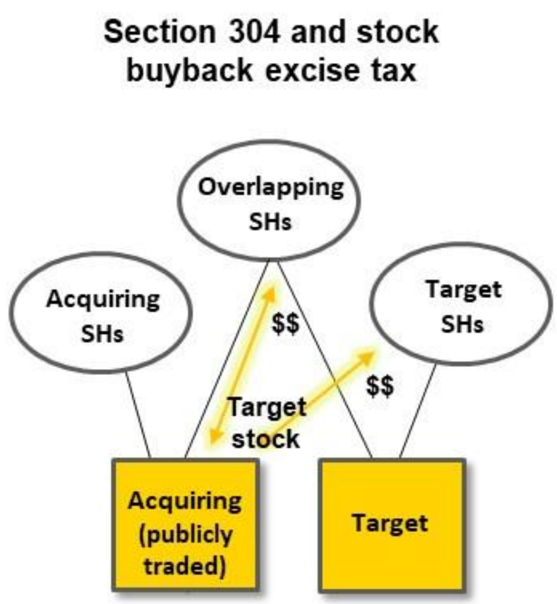
Technical Developments and Musings

Stock repurchase excise tax and the growing "nuisance" of Section 304. About a year ago, this column noted that §304 can have surprising application to combinations of public companies; for example, an all-cash sale of a public target company can raise the prospect of dividend treatment to certain "overlap" target shareholders who also own stock in the acquiring corporation. As a result of the recently enacted Inflation Reduction Act, the "public nuisance" of §304 has expanded due to the new 1% excise tax which, beginning in 2023, is applicable to certain stock "repurchases" made by a publicly traded corporation. To be sure, the prototypical stock acquisition that the excise tax apparently was designed to address will be acquisitions of stock by public companies—typically effected through a broker pursuant to stock repurchase programs—net of stock issuances within the year and subject to certain other employee-related exceptions. But the definition of a repurchase under new §4501 is relatively broad, keyed to a "redemption" within the meaning of §317(b), which would also seem to include other types of transactions treated as "redemptions" under the Code, including deemed redemptions of acquiring corporation stock under §304. Before the new law was enacted, §304 was primarily a concern for those shareholders (e.g., foreign investors) facing potential dividend treatment. Beginning in 2023, however, the concern over §304 tacks the opposite way; i.e., where a deemed redemption doesn't result in a dividend, its status as an "exchange" raises the prospect of a 1% excise tax on the publicly-traded acquiring corporation whose stock is deemed redeemed. For further info on the stock buyback excise tax, see Tax Alert 2022-1206.



Appreciation rights are deductible interest. In a memorandum opinion, the Tax Court held that a partnership and its lender did not form a separate partnership for federal tax purposes and that payments pursuant to an 'additional interest" agreement were deductible under §163. In *Deitch v. Comm'r*, TC Memo 2022-86, the taxpayers were partners in a partnership engaged in commercial real estate development and rental. The partnership obtained a loan from an unrelated life insurance company, which also included an "additional interest" agreement that allowed the lender to share in cash flow and property appreciation. The court rejected the IRS assertion that the lender was in a joint venture, primarily because the IRS and the taxpayers had stipulated that the underlying loan constituted genuine indebtedness pursuant to an arm's length transaction; the court concluded that the additional interest agreement could not be separated from the loan, because the partnership's obligation to pay appreciation interest arose from the same advances that gave rise to its obligation to pay the other interest components, which were concededly deductible.

Merger survivor is consolidated group agent. In CCA 202231014, the IRS concluded that the corporate survivor of a "two step" merger transaction involving the common parent of a consolidated group was the default successor and agent for group, which terminated as a result. Citing Reg. § 1.1502-77, the IRS noted that it had never dealt separately with any member of the terminated group; no other entity had been designated as the agent; and the prior common parent had not resigned as agent for the terminated group.