Policy Backgrounder: Tax Policy Updates

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With the annual tax filing season for individual and most corporate returns coming to an end this week, the Internal Revenue Service (IRS) pointed to customer service improvements. The IRS also announced new regulations governing the corporate stock repurchase excise tax. On another tax-related policy issue, the Senate has yet to vote on the Wyden-Smith tax bill with enhancements to the child tax credit and business deductions that passed the House with strong bipartisan support earlier this year.

- For the 2024 tax filing season, the IRS has touted improved customer service and new electronic tools resulting from additional Inflation Reduction Act resources, which led to the reduction of call wait times to three minutes, in-person support to an additional 170,000 taxpayers, and the ability for taxpayers to respond digitally to all tax correspondence from the IRS.
- The IRS also announced proposed regulations regarding the excise tax that was established by the Inflation Reduction Act (IRA) on stock repurchases by corporations.
- In Congress, the Senate has stalled on voting on the Wyden-Smith tax bill as Senator Mike Crapo (R-ID), Ranking Member of the Senate Finance Committee, and other Senate Republicans raise objections to the provisions in the bill.
- In a late bid to secure the votes for the Wyden-Smith tax bill, Senator Josh Hawley (R-MO) has suggested pairing the bill with his reauthorization and expansion of the Radiation Exposure Compensation Act (RECA) that compensates radiation victims.

Proposed Regulations on Corporate Stock Repurchase Excise Tax

The Inflation Reduction Act (IRA) of 2022 imposed a non-deductible one percent (1 percent) excise tax on the fair market value of stock repurchased by a publicly traded domestic corporation starting in 2023. The tax applies to purchases of corporate stock by specified corporate subsidiaries and foreign corporations, and the law includes exceptions for repurchases that are part of a reorganization, are less than $1 million, are contributed to specified tax-exempt retirement plans, or are treated as a dividend.

Impetus Behind the Enactment of the Corporate Stock Repurchase Excise Tax

Stock repurchases, also known as "stock buybacks," are a method for public companies to distribute earnings to shareholders. Traditionally, stock repurchases have had favorable tax treatment when compared to distributing earnings via dividends because dividends are fully taxable in the period when they are earned while shareholders only have to pay taxes on the realized capital gain for stock repurchases (or defer taxes to the future by holding onto the stock). All else equal, stock repurchases also boost earnings per share, a key metric to assess a company's financial performance.

The Administration views the corporate stock repurchase excise tax as a way to counteract the preferential tax treatment of stock buybacks since the Administration claims "many companies have failed to reinvest profits in their workers, growth, and innovation." Treasury Secretary Janet Yellen said the IRA "helps ensure that large corporations pay their fair share, just as American families do" and also pointed to the regulation's potential to reduce the deficit by closing loopholes. Opponents counter that the tax shifts business' incentives and harms their ability to manage the business.

Overview of Regulations

Since the IRA did not specify a particular due date for reporting or paying the corporate stock repurchase excise tax applicable to the 2023 tax year, the Treasury Department and the IRS must issue regulations specifying how and when affected businesses must pay the tax. Last week, the IRS proposed regulations regarding the reporting and payment of the new excise tax and outlining how the IRS will apply the tax to corporations.

The regulations provide clarity on key terms used in the calculation of the tax. The tax will apply at a rate of one percent of the fair market value of any stock of a covered corporation that is repurchased by the corporation during its taxable year, reduced by the aggregate fair market value of stock issued by the corporation during the taxable year. "Covered corporations" are domestic corporations whose stock is publicly traded on an established securities market (*e.g.,* U.S. national securities exchanges, certain foreign securities exchanges, regional or local exchanges, and certain interdealer quotation systems). "Repurchases" include a corporation's acquisition of any of its stock from a shareholder for property that qualifies as a redemption of the stock as defined in the tax code and "economically similar" transactions, such as buybacks of corporate stock that occur in connection with certain corporate mergers, separations, and other mergers and acquisitions (M&A) transactions or acquisitions of the corporation's stock by certain specified affiliates.

The proposed regulations include an exception stating a covered corporation is not subject to the stock repurchase excise tax if the aggregate fair market value of the stock repurchased by the corporation during the taxable year does not exceed $1,000,000. The regulations also include a rule impacting multinational corporations with foreign parents that avoids covering intercompany funding transactions in the ordinary course of business among corporate affiliates being inadvertently captured. Corporations affected by the tax must report the tax in the Quarterly Federal Excise Tax Return (IRS Form 720) along with Form 7208, which will be used to calculate the tax owed. The IRS is still finalizing these tax forms through the regulatory process, so for corporations with a taxable year ending after December 31, 2022, but before the publication of final regulations, any liability for the stock repurchase excise tax for the taxable year must be reported on the Form 720 that is due for the first full quarter after the date the final regulations are published, and the deadline for payment of the tax is the same as the filing deadline.

Whether the corporate stock repurchase excise tax will lead to greater investment of corporate earnings instead of corporations distributing these earnings to shareholders via dividends remains to be seen. The Tax Policy Center estimates a roughly 1.5 percent increase in corporate dividend payouts as a result of the increase in relative taxation of capital gains. Other organizations believe the outcome is more uncertain and corporations will include the one percent excise tax as one component of their broader decision-making process that incorporates multiple market considerations. Comments on the proposed regulations are due by June 11, 2024, with final regulations expected later this year and implementation likely at some point in 2025.

Status of Wyden-Smith Tax Bill

Earlier this year, the House of Representatives approved in a 357-70 vote a three-year bipartisan tax bill negotiated by House Committee on Ways and Means Chairman Jason Smith (R-MO) and Senate Finance Committee Chairman Ron Wyden (D-OR) that increases both the child tax credit and business deductions for research and development, capital expenses, and interest—which proponents of Wyden-Smith believe would increase US R&D funding. Other provisions include changed reporting thresholds; ending double taxation for businesses operating in Taiwan and the United States; promoting affordable housing construction through enhancements to the Low-Income Housing Tax Credit; and tax relief for taxpayers affected by recent disasters. The bill pays for these provisions by ending the pandemic-era employee retention tax credit early. Nevertheless, the Tax Relief for American Families and Workers Act, colloquially known as the “Wyden-Smith” tax bill, has stalled in the Senate amid opposition from a core group of Senate Republicans led by Senator Crapo and Senate Minority Leader Mitch McConnell (R-KY).

Senate Republican Opposition

Senator Crapo released a statement in late February outlining his policy concerns regarding the expansion of the child tax credit (CTC). The Wyden-Smith tax bill allows prior-year earned income to calculate the maximum child tax credit, meaning that a taxpayer with no income in the current tax year could still qualify for the maximum credit based on their earned income in the prior year. Senator Crapo said, “I remain concerned the CTC provisions undermine the work requirement [attached to the CTC] and represent a significant shift . . . to transform the CTC from primarily working family tax relief into a government subsidy. Allowing individuals to receive a refundable credit when they have zero annual earnings—as the prior year’s earnings provision allows—is a departure from longstanding policy tying the CTC to work.”

Senator Crapo also wants to ensure the child tax credit provides “actual tax relief” to working families, claiming, “[m]ore than 90 percent of the bill’s CTC benefits accrue to taxpayers who will not owe a single dollar of federal income tax—and the 10 percent allocated to those who do will likely not see that relief until the 2026 tax filing season.” Currently, the CTC is a partly refundable tax, meaning a taxpayer can claim a refund even if they do not owe any Federal taxes in a given year. The Administration and other proponents of the child tax credit contend that its expanded refundability during the pandemic contributed to driving child poverty to a record low of 5.2 percent in 2021.

Finally, Senator Crapo has issues with how the agreement between Senator Wyden and Representative Smith came about without securing his support before bringing the bill to a vote in the House. As Senator Crapo elaborated, “[n]otwithstanding my stated concerns, Chairman Wyden and Chairman Smith chose to move forward . . . efforts to pressure the Senate to ‘take it or leave it’ and categorically dismiss a Senate regular order process have only amplified calls for changes and amendments. This was the risk of announcing a deal without my support and with no near-term path forward in the Senate.” Senator McConnell has urged his party to back Senator Crapo’s position on the bill.

Other Senate Republicans are also opposed to the Wyden-Smith tax bill for various reasons. Senator Mitt Romney (R-UT) supports expanding the CTC but prefers his own bill that includes different mechanisms to cover the fiscal costs of expansion, including eliminating the state and local tax (SALT) deduction which many Democrats and some Republicans in high tax states strongly oppose. Senator Thom Tillis (R-NC) wrote an op-ed detailing his concerns; he disagrees with using the early end of the employee retention tax credit to pay for the fiscal costs of the bill (thinking the savings are illusory) and prefers taking up broader tax negotiations next year when certain provisions of the Tax Cuts and Jobs Act expire.

Potential for Last-Minute Breakthrough?

Despite this opposition, some Senate Republicans have publicly supported the bill, including Senators Steve Daines (R-MT) and Todd Young (R-IN). Senator Daines, emphasizing the business deductions in the bill, said, “I want to see something get done. I think we have a good chance to pass it.” Senator Wyden is also open to negotiations, stating, “The American people want to see a bipartisan effort that gets to yes. The clock is ticking, and families are waiting for this help. They’re telling members of Congress they want to see this done.”

In an effort to restart momentum on the bill in the Senate, Senator Hawley has floated the idea of attaching the Wyden-Smith bill to his bill reauthorizing RECA, a compensation program for victims of exposure to nuclear radiation from atmospheric nuclear tests or after employment in the uranium industry.

Senator Crapo is a co-sponsor of the bill reauthorizing RECA, so Senator Hawley hopes this could nudge Senator Crapo to support the combined legislation. Senators Young and Kyrsten Sinema (I-AZ) are lobbying their colleagues to support the Wyden-Smith bill to show Senate Majority Leader Chuck Schumer (D-NY) that supporters have at least 60 votes to bring the legislation up for consideration on the Senate floor. Yet this effort to bring the Wyden-Smith tax bill to a Senate vote will be challenging. Some Republicans are concerned about the cost of Senator Hawley's RECA authorization, and with the end of the tax filing season, the political will to enact significant changes to tax policy will likely diminish over the next few weeks, as Congress (and tax lobbyists) prepared for a much more intense discussion in 2025 over the provisions of the Tax Cuts and Jobs Act that will expire on January 1, 2026 unless renewed, including personal income tax rates, the personal exemption, SALT deduction, and others.

Conclusion

This debate over the Wyden-Smith bill demonstrates the difficulty of considering changes to tax policy in isolation from other provisions of tax law. It is difficult to affect one part of the Internal Revenue Code without affecting others. As both the CTC and business deduction provisions relate to changes made in the Tax Cuts and Jobs Act, some members are reluctant to open some portions of that bill before the broader debate must take place next year, even though the Wyden-Smith bill contains changes important to many members in each party. Further, as the regulations concerning the corporate stock repurchase excise tax show, the IRS can take months if not years to issue regulations to implement significant changes to tax law. As tax policy reemerges as a significant issue in 2025, Congress will be forced to take a more comprehensive approach to assessing changes to the tax code to facilitate productive negotiations.

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