TPC TAX POLICY CENTER
URBAN INSTITUTE & BROOKINGS INSTITUTION

Raising Revenue from Corporations

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Share buybacks

Alice Bonaime | Eller College of Management | University of Arizona

Tax Policy Center & UNC Tax Center Virtual Conference

May 16, 2023

What is a share buyback?

Company

Shareholders

After a buyback…

- **Cash declines and/or liabilities increase** (depending on how buyback financed)**.**
- **Shareholders’ equity declines** because shares outstanding drop.
- *Theoretically, **no change in stock price**.*

Why do firms buy back stock?

- To return cash to shareholders
- To signal good news to the market
- To combat dilution/boost earnings per share

Aggregate shareholder payouts

Billions of inflation-adjusted US$

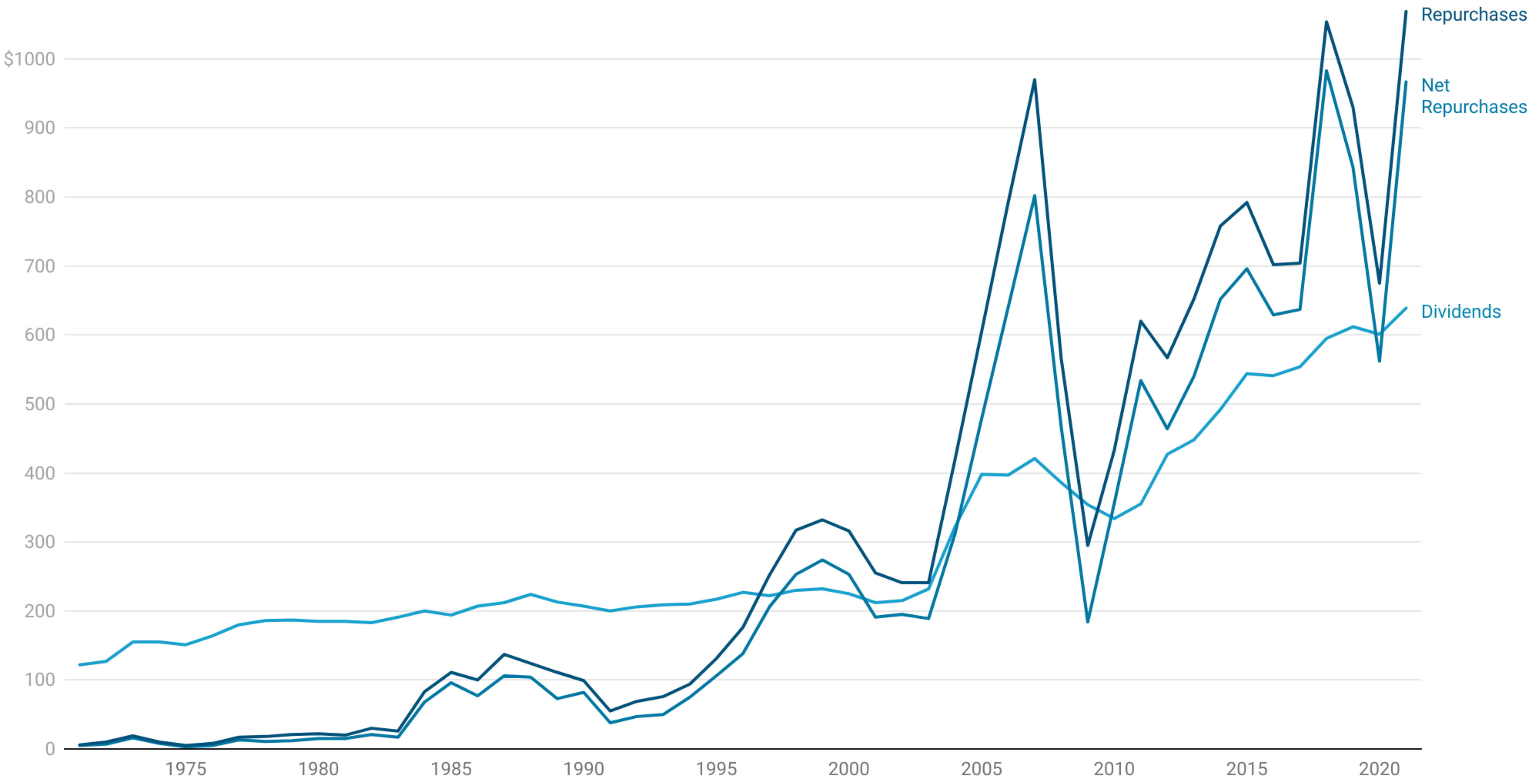
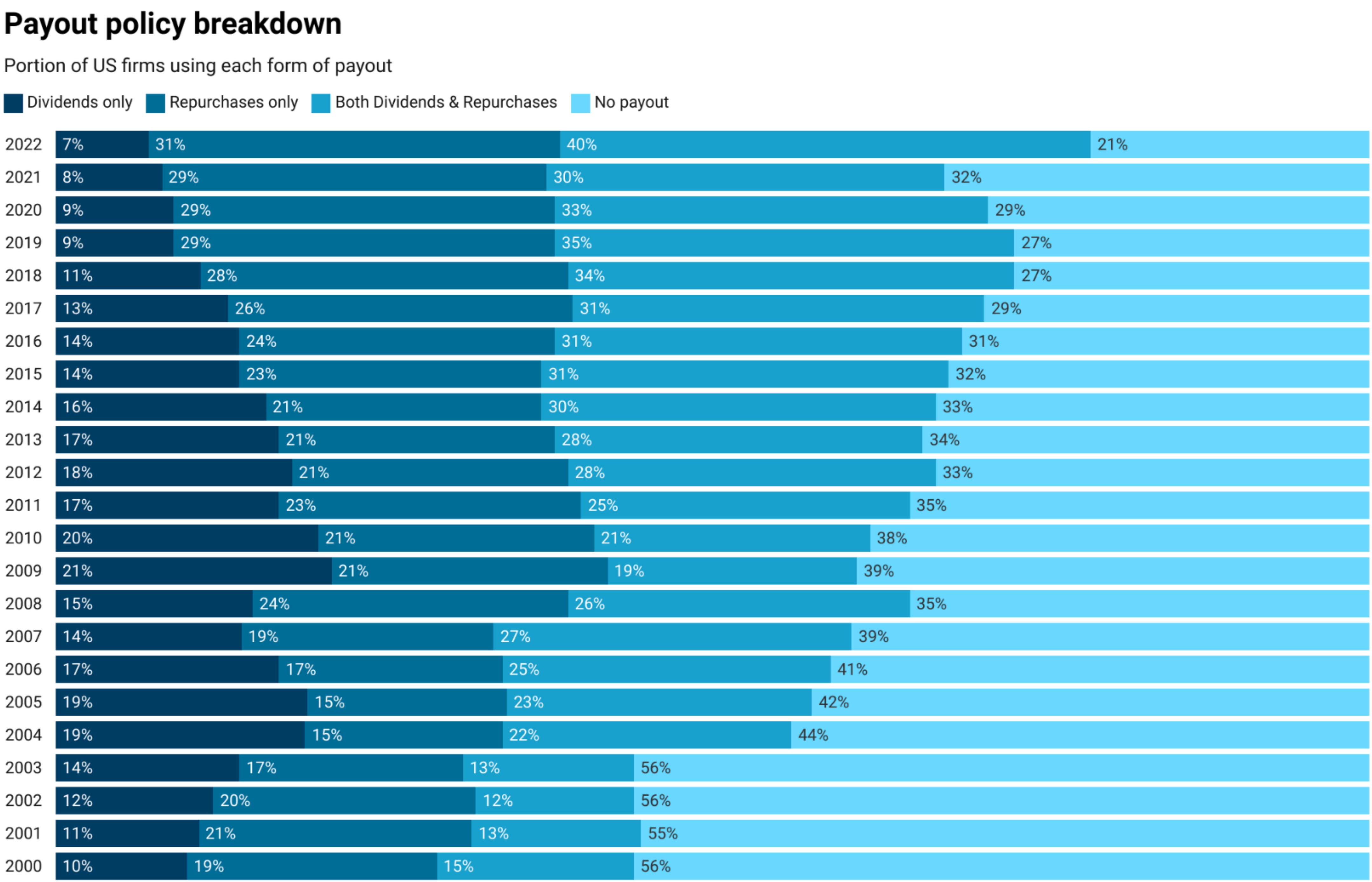


Chart: Dr. Alice Bonaimé • Source: CRSP/Compustat • Created with Datawrapper



Payout policy breakdown
Portion of US firms using each form of payout
Dividends only
Repurchases only
Both Dividends & Repurchases
No payout
2022 7% 31% 40% 21%
2021 8% 29% 30% 32%
2020 9% 29% 33% 29%
2019 9% 29% 35% 27%
2018 11% 28% 34% 27%
2017 13% 26% 31% 29%
2016 14% 24% 31% 31%
2015 14% 23% 31% 32%
2014 16% 21% 30% 33%
2013 17% 21% 28% 34%
2012 18% 21% 28% 33%
2011 17% 23% 25% 35%
2010 20% 21% 21% 38%
2009 21% 21% 19% 39%
2008 15% 24% 26% 35%
2007 14% 19% 27% 39%
2006 17% 17% 25% 41%
2005 19% 15% 23% 42%
2004 19% 15% 22% 44%
2003 14% 17% 13% 56%
2002 12% 20% 12% 56%
2001 11% 21% 13% 55%
2000 10% 19% 15% 56%

Announced repurchases

Billions of inflation-adjusted US$

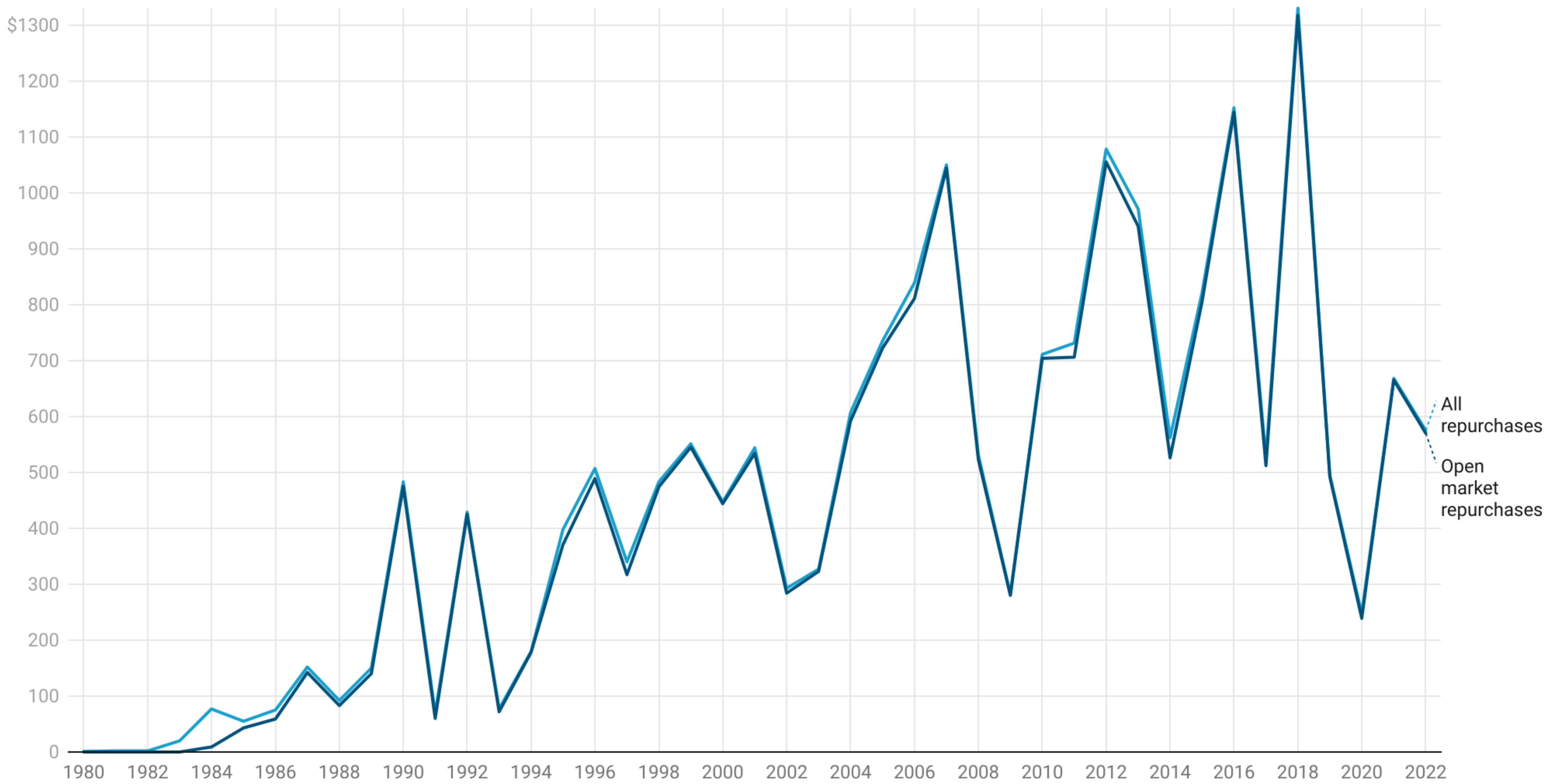


Chart: Dr. Alice Bonaimé • Source: Securities Data Corporation • Created with Datawrapper

Interactive versions of figures can be found at:

https://alicebonaime.com/payout-policy-trends

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US Federal Income Tax Treatment of Dividends and Buybacks (pre-IRA)

Shareholder Type	Dividends	Buybacks	Advantage
U.S. individuals	• ≤23.8% rate • Delayed basis recovery • No non-participation option	• ≤23.8% rate • Immediate basis recovery • Shareholders can choose not to participate and instead to sell when tax-advantageous	Buybacks
Non-U.S. persons	• ≤30% withholding tax	• Generally no U.S. tax	Buybacks
Corporations	• 10.5% rate (50% dividends received deduction) • Delayed basis recovery	• 21% rate • Immediate basis recovery	Mixed
Tax-exempts	• No tax	• No tax	Indifferent

What's the Matter with Buybacks?

1. **"Mark Zuckerberg problem"**
   - Entrepreneurs can form corporations, generate billions in labor income, return cash to shareholders via buybacks, and pay no shareholder-level tax because they won't sell shares until they die
     - If they desire liquidity during their lifetimes, they can borrow against their appreciated stock

What’s the Matter with Buybacks?

2. **“Panama Papers problem”**
   - Foreign investors can stash funds in tax-haven accounts, invest in US stocks, pay no US withholding tax (as long as they receive no dividends), and pay no tax in haven country or home country either

Neutralizing the Tax Advantage of Buybacks

Option 1: Treat buybacks like dividends

- <u>E.g.</u>: If corporation with 100 outstanding shares buys back 10 shares for $1/share, remaining shareholders would be taxed as if they received dividend of $0.10/share and would have their basis increased by $0.10/share
    - <u>Complications</u>
        1. Shareholders would owe tax even if they hadn't received cash
        2. Arrangement would be difficult to explain to retail investors
        3. Hard to implement without violating President Biden's $400k pledge

Neutralizing the Tax Advantage of Buybacks

Option 2: Excise tax

With excise tax on stock buybacks, either:

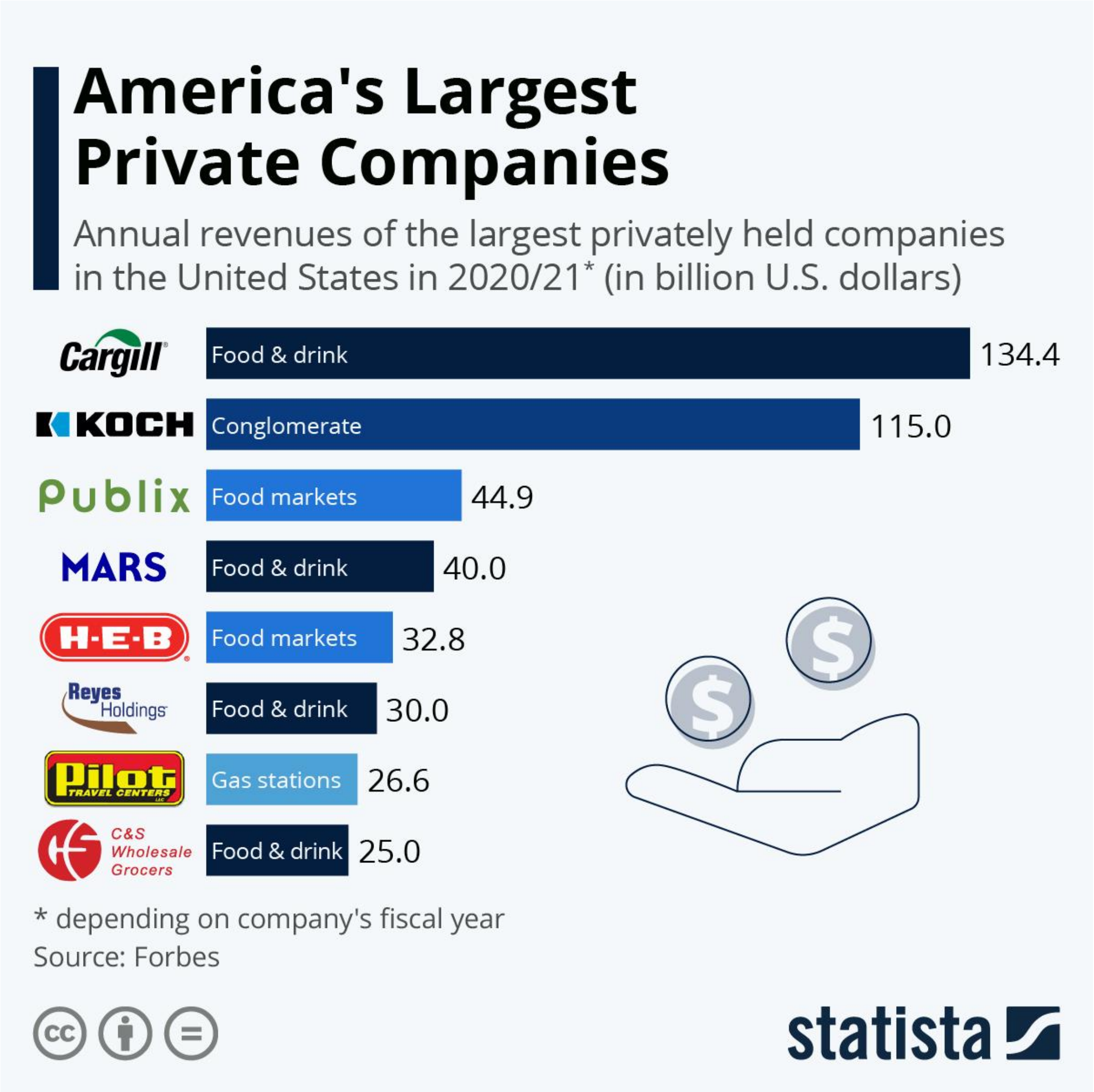
(1) corporations will pay the excise tax (and US will collect some excise tax $$$ from the Mark Zuckerbergs and Panama Papers account holders); or

(2) corporations will shift from buybacks to dividends (and US will collect $$$ via dividend taxation)

Easy to administer; no problem with $400k pledge

Distributional Implications

- With a 1% excise tax, some publicly traded corporations will continue to return cash to shareholders via buybacks rather than dividends
  - Tax-exempts shoulder some of the burden (whereas they don't bear the burden of dividend taxation)
- If excise tax rate is high enough that no one buys back shares, then burden of dividend taxation falls on US taxable individuals and foreigners (especially, foreigners in non-treaty jurisdictions)



Scope Limitations

Why only publicly traded corporations?

- Potential to distort choices about going private/going public if privately traded corporations still have ability to make tax-advantaged distributions of cash to shareholders but publicly traded corporations don't

The New York Times

Amazon to Buy Whole Foods for $13.4 Billion

◆ WSJ NEWS EXCLUSIVE | TECH

Microsoft to Buy Activision Blizzard in All-Cash Deal Valued at $75 Billion

Activision CEO Bobby Kotick is expected to leave the videogame heavyweight that has been roiled by claims of workplace misconduct

By Cara Lombardo Follow , Kirsten Grind Follow and Aaron Tilley Follow

Updated Jan. 18, 2022 5:48 pm ET

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Activision Blizzard's Call of Duty is one of the popular game franchises Microsoft would add to its portfolio. PHOTO: RICHARD B. LEVINE/LEVINE ROBERTS/ZUMA PRESS

Scope Limitations

Why not cash acquisitions?

- When corporation is bought out in cash deal, any earnings are (in effect) returned to shareholders (still US tax-free if those shareholders are non-US residents)

Accidental Taxation

- **“Accidental taxation”:** Application of excise tax to transactions that don’t implicate core concerns that motivated Congress to enact the tax
  - Mandatorily redeemable preferred shares?
  - SPAC liquidations?
- As excise tax rate increases, concerns about “accidental taxation” intensify
- Treasury has broad regulatory authority under § 4501(f) to carve out exceptions for “special classes of stock and preferred stock,” but writing these regs in ways that don’t open up new loopholes is challenging!

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