

# What's News in Tax

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## New Requirements for Issuer Reports on Corporate Actions Affecting Stock Basis

**New reporting rules require corporations to file information returns with the IRS when the corporations engage in actions that affect the tax basis of certain securities. This article considers how the issuer reporting requirements integrate with certain broker reporting requirements and warns that corporations may begin to see the effects of the new reporting requirements on communications with shareholders and the documentation of transactions.**

New reporting rules under section 6045B require an issuer—foreign or domestic—to file an information return with the IRS whenever the issuer engages in a corporate action that affects the tax basis of a “specified security.”<sup>1</sup> In addition, an issuer is required to furnish a written statement with the same information to each holder of the security.<sup>2</sup> Issuers may satisfy these requirements by posting the required information on their primary public Web site.<sup>3</sup> This article explains how these new issuer reporting rules interface with the new broker cost basis reporting regime,<sup>4</sup> provides detail regarding the issuer reporting requirements, and explores how the existence of the issuer reporting requirements may affect the development of corporate transaction documents.

<sup>1</sup> Section 6045(g)(3)(B) defines a “specified security” as any stock in a corporation; any note, bond, debenture, or other evidence of indebtedness; any commodity, or contract or derivative with respect to a commodity (if the IRS chooses); and any other financial instrument (as specified by the IRS).

<sup>2</sup> Section 6045B(c); section 1.6045B-1(b)(2).

<sup>3</sup> Section 6045B(e); sections 1.6045B-1(a)(3) and (b)(4).

<sup>4</sup> For an overview of the cost basis reporting regime, see Dale S. Collinson, Deanna Flores, and Christina Robillard, *Final Cost Basis Regulations Change and Clarify Reporting Requirements for Financial Services Industry*, Vol. 9, Issue 2, J. Taxation of Financial Products 23 (2011).

## I. Broker Cost Basis Reporting Regime

The issuer reporting rules under section 6045B are part of the new broker cost basis reporting regime, effective January 1, 2011.<sup>5</sup> Section 6045(g) expands brokers' reporting requirements. Brokers that are required to file a gross proceeds information return under section 6045(a) for the sale of stock must now include in the information return the customer's adjusted basis in the stock and whether any gain or loss with respect to the stock is long-term or short-term. The same information must also be provided to the customer under section 6045(b). Currently, gross proceeds information is reported on Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*, and the IRS has published a draft revision of that form that includes the additional information.

Section 6045(g) was enacted to create a system for brokers to provide customers with cost basis information that customers could use to report more accurately capital gains and losses from sales of securities. The new regime thus includes rules governing both the transfer of cost basis information when securities are transferred and certain cost basis adjustments brokers must make.

In addition to the broker reporting requirements, section 6045A requires persons transferring securities to provide the transferee with cost basis and holding period information.<sup>6</sup> Securities are often transferred by and to persons who are not "brokers" obligated to report gross proceeds from sales of securities. Accordingly, the regulations broadly define the terms "applicable person" effecting a transfer and "broker" receiving custody to include those other persons. For example, an "applicable person" required to provide a transfer statement generally includes "a person that acts as a custodian of securities in the ordinary course of a trade or business, an issuer of securities, a trustee or custodian of an individual retirement plan, or any agent of these persons."<sup>7</sup>

As described more fully below, both brokers and applicable persons must take into account the information reported by issuers that impacts cost basis.<sup>8</sup> Adjustments reflecting the issuer information may affect cost basis reported on Forms 1099-B or on transfer statements.

Unless otherwise indicated, references to "section" or "sections" in this article are to the Internal Revenue Code of 1986 (the "Code"), as most recently amended, or to the U.S. Treasury Department regulations, as most recently adopted or amended.

<sup>5</sup> Section 6045B is part of the new cost basis legislation enacted under Section 403 of the Energy Improvement and Extension Act of 2008, Division B of Pub. L. No. 110-343, 122 Stat. 3765, 3854 (2008).

<sup>6</sup> Section 6045A (regulatory authority); section 1.6045A-1(a).

<sup>7</sup> Section 1.6045A-1(a)(4); *see also* section 1.6045A-1(a)(5) (definition of "broker" receiving custody).

<sup>8</sup> *See* sections 1.6045-1(d)(iv) and 1.6045A-1(b)(1)(vii).

## II. Section 6045B Issuer Reporting Regime

The section 6045B issuer reporting regime parallels the broker cost basis reporting regime in that reports are required with respect to corporate actions affecting the basis of a “specified security” of an issuer.<sup>9</sup> Section 6045(g)(3)(B) defines a “specified security” as any stock in a corporation; any note, bond, debenture, or other evidence of indebtedness; any commodity, or contract or derivative with respect to a commodity (if the IRS chooses); and any other financial instrument (as specified by the IRS).

Different effective dates, depending on the type of security, apply to issuer reporting and cost basis reporting.<sup>10</sup> For calendar year 2011, issuers need report only corporate actions affecting stock, other than stock of regulated investment companies (“RICs”).<sup>11</sup> Corporate action reporting for RIC stock will be required beginning in 2012.<sup>12</sup> The reporting requirements for other types of “specified securities” do not apply until 2013 or until such later date as may be determined by the IRS.<sup>13</sup>

Pursuant to section 1.6045-1(a)(14), stock includes any share of stock (or any interest treated as stock, including an American Depositary Receipt (“ADR”), in an entity organized, or treated for federal tax purposes, as a corporation (foreign or domestic). Under this definition, interests in a real estate investment trust or exchange-traded fund are treated as stock if the issuers are taxable as a corporation.

### *Corporate Actions*

A corporate action is any action taken by an issuer that would affect the basis of its stock, including:

- Stock splits
- Mergers
- Acquisitions
- Recapitalizations

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<sup>9</sup> Section 6045B(d) provides that for purposes of issuer reporting, the term “specified security” has the meaning given such term by section 6045(g)(3)(B).

<sup>10</sup> See sections 6045B(d) and 6045(g)(3)(C).

<sup>11</sup> Section 1.6045B-1(h).

<sup>12</sup> *Id.*

<sup>13</sup> See sections 6045B(d) and 6045(g)(3)(C).

- Redemptions and distributions (not treated as dividends for income tax purposes)

### *Required Information*

In general, the information return must include:

- The name and taxpayer identification number of the reporting issuer
- The CUSIP or other security identifier
- The contact details of the reporting issuer
- The type or nature of the corporate action
- The “quantitative effect” of the corporate action
- Any other information specified in the form and instructions<sup>14</sup>

The information return must disclose the “quantitative effect” on the basis of the stock in the hands of a U.S. taxpayer as an adjustment per share or as a percentage of the old tax basis, including:

- A description of the calculation
- Data supporting the calculation (such as the market values of the stock and valuation dates)
- The applicable Code section upon which the tax treatment is based
- Any other information necessary to implement the adjustment including the reportable tax year
- Whether any resulting loss may be recognized<sup>15</sup>

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<sup>14</sup> Section 6045(a); section 1.6045B-1(a)(1).

<sup>15</sup> Section 6045B(a)(2); section 1.6045B-1(a)(1)(v).

### *Information Reporting Deadlines*

Section 1.6045B-1(a)(2) requires an issuer to file an information return with the IRS on or before the 45th day following the corporate action or, if earlier, by January 15 of the year following the calendar year of the corporate action.

In addition, an issuer must furnish a written statement with the same information to each holder of the stock or to the holder's nominee, on or before January 15 of the year following the calendar year of the corporate action.<sup>16</sup>

### *Public Reporting Exception*

An issuer is not required to file an information return with the IRS or a statement with a holder or its nominee if, by the due date for those returns, the issuer posts the required information in a readily accessible format on its primary public Website and keeps the information accessible to the public for 10 years.<sup>17</sup>

### *Reasonable Assumptions*

An issuer may make reasonable assumptions in order to report the effect on basis of a corporate action. However, if an issuer is unable to determine what portion of a distribution is a dividend by the 45-day deadline, it must treat the entire amount of the distribution as a dividend.<sup>18</sup> While this does not affect basis, it would require current taxation to the shareholders.

### *Corrected Information Returns*

Corrected reporting is required whenever an issuer determines additional facts that result in a different "quantitative effect" on basis from what was previously reported.<sup>19</sup> This could occur, for example, if an issuer has made reasonable assumptions in order to make a timely initial filing and the actual facts result in a different quantitative effect on basis. The corrected return must be filed with IRS within 45 days of the determination of the corrected facts, and corrected statements must also be provided to stockholders, subject, in both cases, to the alternative of public reporting.<sup>20</sup> There is no cut-off date for amending issuer returns and statements.

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<sup>16</sup> Section 1.6045B-1(b)(2).

<sup>17</sup> Sections 1.6045B-1(a)(3) and (b)(4).

<sup>18</sup> Section 1.6045B-1(a)(2)(ii).

<sup>19</sup> Sections 1.6045B-1(a)(2)(iii) and (b)(2).

<sup>20</sup> Sections 1.6045B-1(a)(2)(iii), (3) and (b)(2), (4).

## *Other Exceptions from Reporting*

### *Exempt Recipients*

No reporting is required if the issuer determines that all stockholders are exempt recipients.<sup>21</sup> Exempt recipients include, among others, corporations (or entities treated as corporations for federal income tax purposes), foreign holders, and tax-exempt organizations.<sup>22</sup> Note that S corporations are no longer considered "exempt recipients." Section 6045(g)(4) modified prior law by requiring that an S corporation (other than a financial institution) be treated as a non-exempt recipient.

An issuer generally can only treat a holder as an exempt recipient if it has actual knowledge that the holder is exempt from tax reporting or obtains a completed exemption certificate from the holder (a Form W-9, *Request for Taxpayer Identification Number and Certification*).<sup>23</sup> However, for purposes of reporting in 2011, an issuer may treat a corporate holder as an exempt recipient based on the indicators described in section 1.6049-4(c)(1)(ii)(A) through (M) (i.e., an issuer may use the so-called "eyeball test" for determining exempt corporate status).<sup>24</sup>

### *Money Market Funds*

Money market funds are excluded from the issuer reporting requirement.<sup>25</sup>

### *Special Rules for S Corporations*

An S corporation issuer is deemed to meet the reporting requirements of section 6045B for any corporate action affecting the basis of its stock if the corporation reports the effect of the corporate action on a timely filed Schedule K-1 (Form 1120S) for each shareholder and timely provides copies to all required parties.<sup>26</sup>

### *Special Rules for Regulated Investment Companies*

The issuer reporting requirements do not apply to RICs until January 1, 2012.<sup>27</sup> Further, for purposes of reporting on or after January 1, 2012, RIC issuers that file Forms 2438 and 2439 (relating to undistributed capital gains) will be deemed to

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<sup>21</sup> Section 1.6045B-1(a)(4).

<sup>22</sup> Sections 1.6045B-1(b)(5) and 1.6045-1(c)(3)(1)(B).

<sup>23</sup> Section 1.6045B-1(b)(5).

<sup>24</sup> *Id.*

<sup>25</sup> Section 1.6045B-1(a)(5).

<sup>26</sup> Section 1.6045B-1(c).

<sup>27</sup> Section 6045B(d) provides that no return is required by issuers with respect to corporate actions affecting specified securities until the applicable date of such security. Under section 6045(g)(3)(C), the applicable date for RIC stock is January 1, 2012.

*The two penalty provisions can result in a combined potential maximum penalty of \$3 million per year.*

meet the requirements of section 6045B if such issuer timely files the returns and provides copies to all required parties.<sup>28</sup>

### *Penalties*

In general, the penalty for failure to timely file a correct information return is \$100 per return (with a calendar year maximum penalty of \$1.5 million).<sup>29</sup>

The penalty rules apply separately to the requirement to provide information to holders or nominees, and thus, a separate \$100 penalty can apply for failure to timely furnish correct information, with an annual maximum penalty for failures of \$1.5 million.<sup>30</sup> The two penalty provisions (under sections 6721 and 6722) can therefore result in a combined potential maximum penalty of \$3 million per year.

## III. Interaction of Issuer Reporting Regime and Broker Cost Basis Reporting Regime

### *Application to “Covered Securities”*

In enacting new cost basis reporting requirements for brokers, Congress recognized that brokers would frequently not have cost basis information for previously acquired securities. So the broker cost basis reporting requirements generally apply only with respect to sales of “covered securities.”<sup>31</sup> Sales of securities that a broker has held in a customer’s account prior to the effective date of the new cost basis reporting rules are not subject to those rules. For example, stock will generally not be a “covered security” unless it is acquired for cash on or after January 1, 2011.<sup>32</sup>

However, the issuer reporting rules apply to all outstanding issued stock, because a share of that stock would become a covered security if it is acquired for cash on or after January 1, 2011. In addition, stock acquired “due to a stock dividend, stock split, reorganization, redemption, stock conversion, recapitalization, corporate division, or other similar action” will be considered acquired for cash, and will therefore be a covered security if it has a basis determined from the basis of a

<sup>28</sup> Section 1.6045B-1(d).

<sup>29</sup> Section 6721. Section 1.6045B-1(f) provides that an issuer will be subject to penalties for any failure to comply unless it is shown that the failure is due to reasonable cause and not willful neglect. See also section 6724(a) and the regulations thereunder for guidance regarding reasonable cause.

<sup>30</sup> Section 6722.

<sup>31</sup> Section 6045(g)(3)(A) generally defines a “covered security” as a specified security acquired on or after an applicable effective date.

<sup>32</sup> Section 1.6045-1(a)(15).

covered security.<sup>33</sup> As a rule, an issuer should therefore assume that brokers will use the information it provides to make required cost basis adjustments for purposes of the brokers' Form 1099-B reporting obligations.

### *The Need for Timely Information*

As noted above, the issuer return is due by the 45th day following the corporate action or, if earlier, January 15th of the following calendar year.<sup>34</sup> The issuer deadline would seem, therefore, to be generally well coordinated with the potential obligation of a broker to provide a Form 1099-B with respect to a sale of affected stock. Problems can still arise if an issuer return is provided after the due date or if an issuer is required to provide a corrected return.

When reporting a sale of a covered security on Form 1099-B, a broker "must take into account . . . all information furnished or deemed furnished on an issuer statement . . . unless the statement is incomplete or the broker has actual knowledge that it is incorrect."<sup>35</sup> Brokers are required to file amended returns with the IRS and provide amended Forms 1099-B to customers if they subsequently receive or are deemed to receive<sup>36</sup> an issuer statement, unless the broker originally reported the required information consistently with the issuer statement.<sup>37</sup> The corrected returns must be filed within 30 days of receipt of the issuer statement. However, corrected returns are not required to be filed if the broker receives the issuer statement more than three years after it filed the original information return.<sup>38</sup>

Persons transferring covered securities may have an even greater interest than brokers in timely issuer reporting. Transfer statements are required to be provided within 15 days after the date of settlement of the transfer.<sup>39</sup> In addition, the transferor must provide a corrected transfer statement for a covered security within 15 days of receiving an issuer statement that contains information that was not reported on the initial transfer statement.<sup>40</sup> The requirement to provide

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<sup>33</sup> Sections 1.6045-1(a)(15)(iii) & (iv)(B).

<sup>34</sup> Section 1.6045B-1(a)(2).

<sup>35</sup> Section 1.6045-1(d)(2)(iv).

<sup>36</sup> If an issuer adopts the public reporting exception by providing the required information on its primary public Web site, the broker will be deemed to receive an issuer statement. Section 1.6045B-1(b)(4).

<sup>37</sup> Section 1.6045-1(d)(2)(vi)(B).

<sup>38</sup> Section 1.6045-1(d)(2)(vi)(C). One might ask why IRS provided a three year limit on the broker's obligation to file a corrected return but no time limit for the issuer's obligation to file a corrected return. A possible explanation is that the issuer correction could affect stock that was acquired before the corporate action and has not yet been sold.

<sup>39</sup> Section 1.6045A-1(a)(3).

<sup>40</sup> Section 1.6045A-1(c)(1).

*Issuers may find it prudent to prepare a draft of the corporate action return for purposes of comparing the information on that return with any tax disclosure that may be included in a prospectus, proxy statement, or other information provided to shareholders.*

corrected transfer statements applies only for 18 months after the initial transfer statement.<sup>41</sup>

One may anticipate that over time, custodians and other “applicable persons” will express a desire for issuers to post their issuer returns as promptly as possible without taking full advantage of the permitted 45 day deadline. The expression of such a desire may initially be muted partly because some relief has been provided with respect to immediate implementation of the transfer statement requirement<sup>42</sup> and because affected persons may be concentrating their attention on other aspects of the implementation of the new cost basis reporting regime.

#### IV. Implications for Corporate Transaction Documentation

As noted above, the IRS has not yet released the information return that issuers will use to report the quantitative effect of corporate actions on cost basis. Nevertheless, issuers may begin to consider whether their transaction documents should take into account actions they may take in complying with the corporate action reporting requirement.

If an issuer elects the public reporting option, the issuer will publish a formal statement regarding the tax consequences of a corporate action shortly after its completion. Issuers may find it prudent to prepare a draft of the corporate action return for purposes of comparing the information on that return with any tax disclosure that may be included in a prospectus, proxy statement, or other information provided to shareholders.

The section 6045(a) gross proceeds reporting rules already required the reporting of some corporate actions. Persons responsible for gross proceeds reporting may consider actions to coordinate the positions taken on their information returns with the positions taken by issuers. For example, the issuance of cash boot in a tax-free reorganization could result in a reportable sale for cash. Accordingly, a paying agent engaged by an acquiring corporation to distribute cash to participating acquired corporation shareholders may have a reporting obligation independent of the corporate action reporting obligation of the acquiring corporation. As a participant in the transaction, the paying agent may have an interest in coordinating its reporting position with that of the acquiring corporation that transcends the interest it would have if it simply was holding shares of an acquired corporation in a customer account. Of course, issuers may have taken positions in the past regarding the tax treatment of their corporate actions—so that arguably the same

<sup>41</sup> Section 1.6045A-1(c)(2).

<sup>42</sup> See Notice 2010-67, I.R.B. 2010-43, 529.

need for coordination existed. It remains to be seen whether the greater formality of an IRS information return will have a significant impact on actual practice.

Some issuers have already filed prospectus supplements for new stock issuances to describe the new stock basis reporting requirements and the issuer reporting requirements.

## V. KPMG Observations

Sometimes the correct tax treatment for a corporate action is not entirely clear. More often, the effect of a corporate action may be different for different stockholders. Commentators have noted that issuers will often be unable to specify the “quantitative effect” of a corporate action on individual shareholders. For example, cash “boot” (or other property that does not qualify for tax-free treatment) in a tax-free reorganization may have different tax consequences for different taxpayers. The basic rule is that a shareholder recognizes gain, but not loss, in an amount equal to the lesser of the gain realized or the cash (or other property) received.<sup>43</sup> The instructions to the issuer information return may clarify what an issuer needs to do in such cases.

Because brokers are required to take into account the information received on an issuer statement (unless the broker knows the information is incorrect), the failure of an issuer to timely report the “quantitative effect” of corporate actions will result in inaccurate reporting by brokers. A broker will be required to amend the inaccurate reporting if it receives a corrected issuer statement within three years, and persons providing transfer statements will be required to provide corrected transfer statements for a period of 18 months. This means that a large and important group of stakeholders will scrutinize issuer corporate reporting compliance efforts, and that should further reinforce the importance of prompt and full compliance by issuers.

The regulations provided under section 6045B devote relatively little attention to the situation of foreign corporate issuers. Nevertheless, foreign issuers whose stock trades on platforms used by U.S. brokers to effect investments for U.S. investors, particularly including ADRs traded on U.S. exchanges, should also be reviewing their reporting requirements and processes with respect to the new requirements.

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<sup>43</sup> Section 356(a).

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The exemption that applies when all stockholders are exempt recipients will exempt many corporate restructurings that involve shifting stock ownership within a corporate group. This exemption should also be reviewed by foreign issuers.



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