Complying with higher corporate action standards: The importance of booking the US taxation of corporate actions correctly, given the new cost-basis reporting law

Stevie D. Conlon
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GainsKeeper, Wolters Kluwer Financial Services, 130 Turner Street, Waltham MA 02453, USA;
Tel: +1 847 652 6893; Fax: +1 781 907 6678;
E-mail: stevie.conlon@wolterskluwer.com

__Stevie Conlon__ joined GainsKeeper as Tax Director in January 2007, prior to which she was Senior Tax Editor for the CCH Capital Changes Reporter, another Wolters Kluwer Financial Services business. Previously, she had been a tax partner at the national law firm Katten Muchin Rosenman and the international law firm Baker & McKenzie. Stevie graduated summa cum laude from Loyola University of Chicago School of Business and cum laude from Loyola's School of Law. She is a member of the New York and Illinois Bars and is also a certified public accountant (CPA). Stevie is a prior chair of the American Bar Association Tax Section's Financial Transactions Committee. She is the lead author of the tax law treatise Principles of Financial Derivatives: U.S. and International Taxation *(RIA, 1999), is on the board of the* Derivatives Report *and the* Journal of Taxation of Financial Products*, and has authored or coauthored over thirty papers on the taxation of financial products that have appeared in prominent industry publications and the financial press. She is the author of commentary on an earlier version of the cost basis reporting legislation provided to the Senate Finance Committee in June 2007. Stevie gratefully acknowledges the contributions of her colleagues John Kareken, Robert Oh and Chris Hamel.*

Abstract

Newly enacted cost-basis reporting law requires brokers to provide the Internal Revenue Service (IRS) and US taxpayers with the adjusted basis and long-term/short-term character of gains and losses for stocks and other covered securities disposed on Form 1099-B. These new requirements will likely affect broker and custodian analysis of corporate actions, given the potential IRS penalty risks. A summary of some of the tax issues currently raised by corporate actions is provided because brokers will need to reassess their methods and assumptions regarding the US federal income tax treatment of corporate actions. This is due to their impact on the computation of basis and the holding period that will be required in complying with the new law.

Keywords: cost basis reporting law; corporate actions; wash sales; tax information processing systems automation software

THE NEW COST-BASIS REPORTING LEGISLATION RAISES THE BAR

On 3rd October, 2008, President Bush signed into law HR 1424, the Emergency Economic Stabilization Act of 2008, in response to the financial market crisis ('the Act', Pub L No. 110-343). Buried in the Act, and included at the last minute as part of an energy and tax extenders package that was added to ob-

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tain favourable votes, was the provision requiring cost-basis reporting by brokers to the Internal Revenue Service (IRS) and taxpayers.[1] One of the reasons that this provision was included was that it was scored to raise US$6.67bn in additional tax revenue over a ten-year period.

The Act provides for a three-tiered effective date and cost-basis reporting is to be required in the following order:

1. stock acquired on or after 1st January, 2011;
2. mutual fund and dividend reinvestment plan (or similar arrangement) stock acquired on or after 1st January, 2012;
3. debt instruments, options or other covered securities acquired on or after 1st January, 2013.[2]

Some brokers and custodians have relied on simplifying assumptions in the booking of the US income tax effects of corporate actions on customers' holdings.[3] This was done at their own peril using simplified methods that were often justified based on a cost–benefit analysis of the risk of processing the tax consequences of a corporate action incorrectly. In some cases, the subsequent discovery of a tax error in booking a corporate action resulted in a broker or custodian providing the customer with financial compensation for their loss due to the error. Such recompense was, however, *ad hoc* and limited in nature.

Under the Act, failure to provide the IRS and taxpayers with accurate Form 1099-B information, setting forth adjusted cost basis and short-term/long-term gain or loss information for covered securities, could subject brokers to significant tax-penalty risk.[4] Currently, the penalty for an error is US$100 per incorrect Form 1099 (a US$50 penalty for providing the IRS with an incorrect Form 1099 and another US$50 penalty for providing the taxpayer with an incorrect Form 1099), subject to a current maximum on the broker for all failures during a single calendar year of US$350,000 (US$250,000 on the returns provided to the IRS and US$100,000 on the returns provided to taxpayers).[5] If the error is due to intentional disregard, the penalty is essentially the greater of US$200 or 10 per cent of the amount required to be reported correctly, without any maximum limitation.[6] Moreover, there has recently been, and there is likely to be future, legislation to raise these penalties and their associated maximum limits. On top of all of that, the IRS assesses interest on penalties and the interest charge can be substantial.[7]

The risk of substantial penalties and interest for incorrect adjusted-basis information could have a profound effect on the standard of care used by brokers and custodians in processing the tax consequences of corporate actions and the systems employed by them to process such information. The new cost-basis reporting law includes a new Code §6045B that requires issuers of specified securities subject to cost-basis reporting to provide the IRS and holders (or nominees) with a statement setting forth the details relating to corporate actions, including the quantitative effect on the basis of such actions (the 'new IRS corporate action reporting rule').[8] Issuers of securities subject to corporate action reporting under new Code §6045B will be also subject to penalty and interest risk, as generally described above regarding Form 1099s.[9]

It could be argued that the new IRS corporate action reporting rule mitigates the burden on brokers and custodians of correctly reporting the tax consequences of corporate actions. This was its intention — but there remain significant concerns. For one thing, the new IRS corporate action reporting rule becomes effective at the same time as the new cost-basis reporting rule for stock applies to newly acquired stock — ie, as of 1st January, 2011. Thus, brokers and custodians will need to grapple with the bugs and snags that are foreseeable while issuers of securities become subject to the new IRS corporate action reporting rules. They will also need to retool their processing systems to handle the new IRS required statements (or publicly available information, if the IRS goes down this route).

One particular concern is that under code §6045B(c) of the new IRS corporate action issuer reporting rule, the issuer is only obligated to provide holders with the corporate action information on or before 15th January of the calendar year following the year of the corporate action. Unfortunately, most brokers and custodians update corporate actions information daily, and the delayed delivery deadline for the issuer corporate action statement could mean serious headaches. Brokers and custodians could be forced to retroactively adjust positions booked throughout the year once the post-year end IRS statements are received.

In addition, the new cost-basis reporting law does not provide that a broker subject to Form 1099 basis reporting is relieved of its obligation to report the adjusted basis correctly if it does not receive a statement from a security issuer under the new IRS corporate actions reporting rule. Thus, brokers will need to develop systems and standards with which to address the gaps or shortfalls in information needed for those cases in which a statement is not received, in order for the broker to meet its Form 1099 reporting requirement.

The development of such systems and standards may be particularly important and difficult in cases involving non-US-issued securities. Investors and brokers continue to expand their investments in non-US securities. Unfortunately, in many cases, the issuers of such securities rarely provide US tax information relating to the consequences of their corporate actions. Moreover, it is conceivable that the issuers of some foreign securities may not be subject to the new IRS corporate actions reporting rule due to jurisdictional limitations or may simply not comply. In these cases, the broker will essentially be left holding the bag — and will need to compute the adjusted basis on the related securities, based on the limited information available to it.

In addition to corporate action concerns, the cost-basis reporting legislation also requires brokers and custodians complying with cost-basis reporting to adjust the basis for wash sales using a specified simplified method.[10] The basis adjustments and the related impact on holding period calculations (which affect whether gain or loss is long-term or short-term) can be significant. This paper does not address the wash sale-related concerns.

Also, the cost-basis reporting legislation requires reporting of short sales, fixed-income securities and options.[11] These securities and transaction types raise their own tax issues that impact cost-basis reporting compliance. This paper does not address such types or the related cost basis, holding period or cost-basis reporting concerns.

Finally, the new cost-basis reporting rules will require brokers and custodians to provide customers and prepare Form 1099-B cost-basis information based on each customer's selection (or election out) of a specified lot-relief method (such as first-in, first-out, specific ID or other permitted methods) for determining the particular lot(s) that are disposed of when stock is sold.[12] Thus, brokers' and custodians' cost-basis systems must essentially support all applicable lot-relief methods for each customer. This requirement could strain some automated systems. This paper does not address lot-relief method concerns.

The bottom line is that the new cost-basis reporting legislation raises the bar for broker and custodian reporting of the tax consequences of corporate actions. They will now need to be concerned about potential tax penalties and related interest risk for reporting incorrect information concerning the adjusted basis and holding period. This will necessitate a greater focus on tax accuracy of corporate action-related basis adjustments, and the need for systems to both process information received from issuers of securities under the new IRS corporate actions reporting rule and to 'gap fill' when information from such issuers is lacking.

COMMON US TAXATION OF CORPORATE ACTION CONCERNS

There are a variety of corporate action types and each one raises different tax concerns. This paper will focus on a few common types of corporate action and some of their associated tax issues.[13] In almost all corporate actions, it must be considered whether the action results in a taxable event requiring the recognition of gain or loss, whether any associated distribution results in ordinary income, capital gain, loss or return of capital, and whether, on the receipt of a security or property, the basis in the related security must be divided in some fashion and a portion allocated to such security or property received.

Stock splits and stock dividends

Stock splits and stock dividends are generally tax-free events for federal income tax purposes.[14] There are a couple of complications that arise, however, which can have a significant impact,[15] the most common of which are:

- if the shareholder has the right to elect to receive stock or cash, the receipt of stock is not tax-free, but is instead treated as a dividend under the normal tax rules for dividends;[16]
- distributions of stock on preferred stock (rather than common stock) are generally taxable under the dividend rules.[17] 'Preferred stock' is a term of art under this provision of the Code, so the features of the stock may need to be examined to determine whether it is considered preferred stock for this purpose.[18] This determination can be vexing in the case of certain foreign stocks that may be designated as preferred, but which may not be treated as preferred stock for the purposes of this rule;
- the basis of the old stock held by the taxpayer must generally be allocated between the old stock and the new stock received.[19] The applicable IRS regulations generally require that the basis allocation is made '*in proportion to the fair market values of each on the date of distribution*'.[20] It is commonplace for issuers and others to err and use a date other than the distribution date (such as the ex-date) for the purposes of making this allocation.[21]

It is possible that some may have glossed over these concerns in corporate actions processing.

Stock rights

The receipt of stock rights on common stock are generally tax-free for the same reasons as described above regarding stock splits and stock dividends.[22] Of course, the same limitations also apply. Thus, some stock right distributions could be taxable as dividends.

Stock right distributions also raise a unique basis allocation issue. Unless the fair market value of the stock rights at the time of distribution equals or exceeds 15 per cent of the fair market value of the old stock at such time, there is a zero basis allocated to the stock rights received and the basis of the old stock to which the rights relate is unaffected by the distribution.[23] A taxpayer can, however, elect to override this zero-basis allocation rule and allocate a portion of the old stock's basis under the 'general fair market value on date of distribution' allocation rule described above (the election must be made no later than the extended due date of the tax return for the year in which the rights were received).[24] If the zero-basis allocation rule does not apply because the 15 per cent threshold is met or exceeded, the taxpayer's basis in the old stock is subject to mandatory allocation between the old stock and the rights received under the general fair-market-value allocation rule previously described. Thus, brokers and custodians tracking an investor's cost basis in their stock holdings will need to test correctly for whether the threshold has been met and will also need to adjust the basis if the investor made the override election.

Stock redemptions and cash tender offers

Corporations regularly redeem their stock. In some cases, the redemption is mandatory; in others, the company will issue a tender offer soliciting holders to turn in their stock. It is often assumed that a redemption of stock for cash is automatically a gain/loss recognition event in relation to which the adjusted basis in the stock redeemed is subtracted from the amount of cash received to compute gain or loss. This is not always the case. Code §302 sets forth rules that must be applied in determining whether a redemption of stock results in gain or loss (with an offset for the adjusted basis of the stock redeemed), or is instead treated as dividend generally taxable as ordinary income under the corporate distribution rules of the Code (with generally no offset for the adjusted basis of the stock in computing the amount of income recognised).[25]

The determination of whether a redemption meets the rules permitting gain or loss treatment is, in many cases under the Code, principally a determination of fact relating to the shareholder's ownership interest in the corporation before and after the redemption.[26] The shareholder's ownership for this purpose must take into account the constructive ownership of shares by the taxpayer of shares owned by certain family members, and by attributing certain shares from partnerships, estates, trusts and corporations.[27] Thus, the disclosure statements prepared by tax counsel to corporations redeeming their stock are often uncertain regarding the tax treatment because, in almost all cases, the facts relating to the ownership of stock by shareholders under the constructive ownership rules are unknown to them.

The determination of whether a redemption is taxed as gain or loss, or as a dividend, has additional ramifications. US source dividends paid to non-US taxpayers are generally subject to US withholding tax (although the amount of tax withheld may be reduced pursuant to an applicable tax treaty).[28] Payors are subject to liability for withholding tax. Thus, at least one custodian had concerns that the potential treatment of the redemption of stock in a so-called 'self-tender' by the corporate issuer could result in withholding tax liability to the payor of cash on a redemption of stock made to non-US persons and sought a private letter ruling from the IRS.[29] The IRS ruling approved a payor procedure to deliver and require a statement from holders, along with a related potential escrow of holder funds. Once the private letter ruling was issued, other custodians became concerned regarding the potential withholding tax liability on redemption payments made to non-US persons.

In October 2007, the IRS issued proposed regulations in response to these concerns.[30] Unfortunately, the procedures set forth in the proposed regulations appear cumbersome and many in the industry have commented to the IRS on the significant burdens that they create.[31] The concerns raised in connection with the proposed regulations could also raise similar concerns regarding the proper method for brokers and custodians to book the tax consequences of redemptions as either gain or loss (with an offset against the adjusted basis) or as a dividend.

Distributions on stock: the return of capital and non-cash property

Under US federal income tax law, the taxation of distributions of cash or property with respect to stock generally depends on the paying corporation's earnings and profits.[32] If the distribution exceeds current and accumulated earnings and profits, the amount in excess is treated as a return of capital.[33] The return of capital reduces the holder's adjusted basis in the stock until it is zero and any amount in excess thereof is treated as capital gain.[34]

Regularly each year, there are returns of capital disclosed in connection with some distributions on stock. Returns of capital are most common with real estate investment trusts (REITs) — ie, entities taxed as corporations, but subject to additional special tax rules — but they also occur regularly in connection with distributions on stock issued by other corporations. One vexing difficulty is that it cannot be determined with certainty whether a distribution is a return of capital until after the close of the corporation's tax year, because, until the close of such year, the corporation's current earnings and profits cannot be calculated. Thus, REITs regularly provide statements to their investors setting forth the actual amount of distributions treated as dividend income (broken into various special types of dividend) and the amount treated as a return of capital for distributions made throughout the prior calendar year. Investors must then readjust the basis in their shares based on the post-year-end statement received. Note that these readjustments typically affect both income and the adjusted basis of the related REIT shares (to the extent of any distributions identified as a return of capital). These distributions on REIT shares can occur monthly, so the related adjustments that must be made can be fairly tedious.

As mentioned earlier, there are occasionally returns of capital on non-REIT stock. Basis adjustments must be made in such cases. These occur more infrequently, however, and generally do not involve as many distributions and related adjustments during the prior calendar year. Moreover, it is important to consider the running total of returns of capital distributed against a particular lot of stock. As described above, once the holder's basis is reduced to zero, any excess is taxed as capital gain. It is possible that brokers and custodians may not track such running totals, and therefore may not fully account for returns of capital-related adjustments or amounts in excess of basis.

Non-cash property distributions on stock are generally treated as dividends under these same basic corporate distribution rules. This can be a concern, because some may incorrectly assume that distributions of property such as stock of another corporation are always tax-free. The amount of the distribution is based on the fair market value of the property determined as of the date of distribution.[35] The basis of such property would equal the fair market value as determined and the holding period would begin the next day.

Mergers and voluntary mergers

There are two fundamental concerns relating to the tax consequences of a merger where a holder gives up his or her stock and receives stock (or cash and stock) in a different corporation. Firstly, not all mergers are tax-free. The tax law has some specific rules under the corporate reorganization provisions that must be met in order for a merger to qualify as a tax-free exchange.[36] Sometimes, it is obvious that they are not met or counsel provides an opinion stating that the merger is taxable, rather than tax-free. If the merger is tax-free, all, or a portion, of the holder's basis in his or her stock carries over to the new shares received.[37] If the merger is taxable, however, gain or loss is computed by subtracting the basis of the stock surrendered from the sum of the cash and/or the fair market value of property (such as stock in the acquiring corporation) received.[38] Thus, brokers and custodians must be careful to assess whether a particular merger is taxable or tax-free in order to compute gain or loss, and the investor's basis and holding period in the acquiring company stock, correctly.

The second general concern arising with mergers relates to understanding and correctly applying the so-called 'boot rule'.[39] Even though many mergers qualify as tax-free, investors relinquishing target company stock are generally subject to tax if they receive acquiring company stock and cash. The computation of the amount of gain subject to tax in such cases is based on the boot rule, which is generally described as follows:

> capital gain recognized (subject to Sec. 302) equal to the lesser of (1) the excess, if any, of (a) sum of cash (excluding cash for fractions) plus fair market value of new common received over (b) basis of old common surrendered, and (2) cash received (excluding cash for fractions).[40]

Loss cannot be recognised by the holder, so sometimes the rule is shorthanded as the 'gain but not loss rule'.[41] Under the boot rule, a holder may be taxed on gain in an amount equal to the entire amount of cash received (because of the formulation of the rule).[42] This can be counterintuitive, because some may believe that they should be able to reduce the amount of gain recognised by a proportionate share of the basis in the old stock exchanged against the cash received. Such a reduction is not permitted under the rule. This concern can be a problem because the boot rule and its application can be confusing to some broker and custodian personnel responsible for processing corporate actions. Moreover, in some mergers, cash is received that is not subject to the boot rule, but which is instead treated as a regular dividend generally taxable as ordinary income. Brokers must be able to account for cash under these circumstances as dividends rather than under the boot rule.

A voluntary merger describes a merger in which a holder of the target company stock is provided with choices regarding the consideration that they will receive such as 'all stock', 'all cash', or some combination of stock and cash for either some or all of his or her shares. The tax consequences to the investor can depend on the particular choice selected. Broker and custodian corporate action systems may have difficulty processing the particular choices different customers make for the same merger. They may simply assume that one of the options has been selected for all of their customers. Moreover, the amount of cash or stock under one or more of the choices may change between the time at which the merger is first announced and that at which the merger terms become final. Tracking and correcting these amounts may also pose problems for brokers and custodians. The new cost-basis reporting law and the related penalty risk may make the accurate tracking of voluntary mergers for each customer essential.

Spin-offs and distributions of other stock

Just as all mergers are not tax-free, the same principle applies with respect to the tax treatment of spin-offs and similar distributions of other stock when the investor continues to retain the shares on which such a distribution is made. As an overarching matter, qualifying for tax-free treatment for spin-offs and similar distributions is significantly more difficult under US federal income tax law and generally requires an analysis of the corporate issuer's businesses.[43]

There are also two general concerns regarding such distributions. The first relates to distributions of stock by small, thinly traded start-up companies. Such companies rarely provide a tax opinion and information regarding such companies is generally scant. Thus, brokers and custodians may be forced to develop a default method for handling spin-offs and stock distributions by such companies. A flat assumption that such distributions are non-taxable may need to be re-examined in light of the Form 1099 tax return and penalty risks. The second concern relates to these types of transactions involving foreign companies. US tax opinions may be rare. Similar concerns regarding whether to treat such corporate actions as taxable or tax-free arise. Under the new cost-basis reporting law, accuracy and penalty risks may necessitate a reconsideration of appropriate default assumptions and treatment by brokers and custodians.

Spin-offs have resulted in drastic corporate action processing failures in the past.[44] So-called 'multi-legged' spin-offs result in a holder receiving more than one new stock or security with respect to the stock that he or she already owns. The proper allocation of basis among multiple stocks or securities can be difficult and some systems cannot handle such allocations. Brokers and custodians will need to reconsider these limitations, given the new law.

Worthless and bankrupt securities

The proper tax treatment of stocks and securities that become worthless, or upon the bankruptcy of the respective issuer, raises additional issues. In many cases, stock essentially becomes worthless upon the filing of bankruptcy by the issuer.[45] Brokers and custodians may look to the delisting of publicly traded securities as an indicator. One concern relates to the appropriate date on which an investor can take a loss for a worthless security that he or she continues to hold. Because the loss can only be taken in the year during which the security becomes wholly worthless, speculative trading of shares for even nominal amounts can raise concerns regarding whether the loss can be taken.[46] Although this issue may raise concerns for customers (and therefore for their brokers and custodians), it may not be specifically relevant with regard to cost-basis reporting, because it may not be directly linked to a Form 1099 filing requirement.

A second concern relates to the tax consequences of exchanges of old securities for new securities in bankruptcy reorganisations. Currently, the tax-related explanations provided to investors in such cases are generally extremely unclear and confusing. Here, the concern is more direct, because brokers will need to determine whether such exchanges trigger gain or loss, or result in ordinary income, and the manner in which a customer's basis in its exchanged securities may transfer over to one or more new securities received.

SPECIAL CONCERNS FOR FOREIGN SECURITIES

Corporate actions relating to foreign securities held by US investors raise a host of US federal income tax concerns. As indicated above, in many cases, no US tax opinion is provided to investors in connection with such corporate actions. It can be difficult for US brokers and custodians to discern the relevant facts necessary to assess the proper tax treatment of such actions independently, and potential language and document access barriers must be considered. US tax law may treat some routine non-US corporate actions radically differently from how they are treated under applicable foreign law of the corporate issuer. For example, UK companies have regularly issued so-called 'redeemable B stock', the terms of which generally result in US dividend tax treatment as opposed to gain or loss redemption treatment.

In addition, the US federal income tax law includes special rules referred to as the 'passive foreign investment company' (PFIC) rules, which can result in draconian tax consequences to US investors holding stock in a PFIC in connection with corporate actions.[47] For example, a corporate action that might ordinarily result in capital gain or loss might result in ordinary income and tax at an imputed, compounded rate.[48] Also, a corporate action that might qualify as a tax-free reorganisation under the normal US tax rules relating to reorganisations might be treated as fully taxable.[49]

Unfortunately, the determination of whether a foreign corporation is classified as a PFIC is highly factual.[50] Foreign corporations may, but often do not, provide investors with guidance regarding their PFIC status for any particular tax year. PFIC issues can radically alter the anticipated tax treatment of corporate actions. Thus, brokers and custodians may need to carefully consider PFIC-related risks for investments in foreign corporations. It is not clear whether the required corporate actions reporting under new Code §6045B will adequately address such risks.

CONCLUSION

Brokers and custodians will have their hands full preparing for the new cost-basis reporting law. The reporting requirement and the related penalty risk are likely to force brokers and custodians to reassess the adequacy of their existing systems and methods for determining the adjusted basis of their customers' stock and securities holdings. Corporate actions are only one important element of determining the correct adjusted basis and holding period of stock and securities, as required by the new law; although new Code §6045B will require corporate issuers to provide investors and their nominees with information regarding the effect of corporate actions on cost basis, it remains to be seen whether such information will be adequate or timely for brokers and custodians, given their obligations. Moreover, corporate actions raise a number of concerns that can make the determination of whether a particular corporate action is taxable or tax-free, and the related determination of its impact on basis and holding period, complex or unclear. Brokers and custodians will likely need to reassess the adequacy of existing assumptions and methods that they use in making such determinations. Unfortunately, the clock is ticking and there is little time for brokers and custodians to prepare before the new cost-basis reporting rules become effective.

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Disclosure: GainsKeeper and Wolters Kluwer Financial Services could benefit from the broker basis reporting law.

References

(1) Act §403. For an excerpt setting forth the cost-basis reporting provisions of the Act, see http://www.costbasisreporting.com/pdf/TITLEIVSEC403.doc.

(2) See references to 'applicable date' set forth in new subs. (g)(3)(C) added to Internal Revenue Code (hereafter 'Code') §6045, pursuant to Act §403(a)(1).

(3) 'Corporate action' is generically used herein to reference any issuer action affecting the name, class, ID, quantity of any stock or security, the distribution thereon of additional identical securities or other securities, the merger or exchange of such stock or security for one or more other securities, or other consideration or the extinguishment of such stock or security in connection with an insolvency or bankruptcy proceeding.

(4) The requirement for brokers to provide Form 1099-B is set forth in Code §6045. Cost-basis reporting of the adjusted basis of securities sold is required pursuant to a new subsection (subs. (g)) added to Code §6045. Code §§6721–6724 set forth the IRS penalty provisions relating to incorrect information returns, including information returns required to be filed and delivered to taxpayers under Code §6045.

(5) See Code §6721(a)(1) and §6722(a).

(6) Code §6721(e), setting forth a greater of US$100 or 5 per cent of the amount penalty for the incorrect information reported to the IRS and Code §6722(c), setting a similar greater of US$100 or 5 per cent of the amount penalty for the incorrect information reported to the taxpayer.

(7) Code §6601(e)(2)(A). Interest runs from the date of the notice to the date of payment and is compounded daily.

(8) Act §403(d)(1). The statement must be provided within 45 days after the date of the corporate action or 15th January of the following calendar year (if earlier). Code §6045B(e) permits the IRS to waive the statement filing requirement if it so chooses, provided that the required information is made publicly available in an acceptable format.

(9) Act §403(d)(2).

(10) Code §6045(g)(2)(B)(ii).

(11) Code §6045(g)(5) addresses reporting for short sales; Code §6045(g)(3)(B)(ii) addresses reporting for fixed-income (debt) securities; and Code §6045(h) addresses reporting for options.

(12) Code §6045(g)(2)(B)(i) generally requires lot relief '*in accordance with the first-in first-out method unless the customer notifies the broker by means of making an adequate identification of the stock sold or transferred*' and, in the case of mutual fund and dividend reinvestment plan or similar arrangement stock eligible for the average basis method, '*in accordance with the broker's default method unless the customer notifies the broker that he elects another acceptable method*'.

(13) The discussion will be limited to corporate actions relating to stock issued by entities taxed as corporations for US federal income tax purposes. The list of specific tax issues addressed herein is not intended to be comprehensive. Moreover, the discussion of tax issues herein is general in nature.

(14) Code §305(a). Reverse stock splits are generally analysed as Code §368(a)(1)(E)

recapitalisations under the reorganisation rules applicable to corporations.
(15) See Code §305(b) and (c).
(16) Code §305(b)(1).
(17) Code §305(b)(4).
(18) See Treas. Reg. 1.305-5(a).
(19) Code §307(a).
(20) Treas. Reg. 1.307-1(a).
(21) The Capital Changes Reporter provides its own allocation calculation based on the date of distribution if prices are available.
(22) Stock rights are treated as stock and therefore analysed under the rules previously discussed. See Code §305(d)(1).
(23) Code §307(b)(1).
(24) Code §307(b)(2).
(25) See Code §302(b) and Treas. Reg. 1.302-1(a).
(26) See Code §302(b)(2), (b)(3), and (b)(4). The determination of whether a redemption is '*essentially equivalent to a dividend*' under Code §302(b)(1) is more a matter of law and fact.
(27) See Code §§302(c) and 318.
(28) See, generally, Code §1441.
(29) Priv. Ltr. Rul. 200552007 (dated 27th September, 2005).
(30) See Prop. Reg. 1.1441-3(c)(5), REG-140206-06 (17th October, 2007).
(31) See, eg, 'Speakers at IRS hearing say proposed withholding regs not administrable', 2008 TNT 26-2 (7th February).
(32) Code §§301(c)(1) and 316(a).
(33) Code §301(c)(2) and Treas. Reg. 1.301-1(a) and (f).
(34) Code §301(c)(3)(A).
(35) Treas. Reg. 1.301-1(b).
(36) See, generally, Code §368. Note, however, that some mergers are structured under Code §351.
(37) See, generally, Code §358.
(38) Code §1001.
(39) Code §356(a)(1). For a more detailed explanation, see Conlon (2006) 'The boot rule explained and computation of basis in tax-free combination mergers', 3 Capital Changes In-Depth 1 (Capital Changes Reporter, 27th January).
(40) This is a version of the standardised summary of the rule provided by the Capital Changes Reporter in its applicable publications.
(41) Code §354(a) sets forth the general rule that stockholders recognise neither gain nor loss on an exchange under a tax-free reorganisation. Code §356(a) requires the recognition of gain when cash is also received, but there is no relief therein from the prohibition against the recognition of losses set forth in Code §354. See also Treas. Reg. 1.356-1(a)(2).
(42) See the flush language at the end of Code §356(a)(1), Treas. Reg. 1.356-1(a)(1) and the examples set forth in Treas. Reg. 1.356-1(d).
(43) For a more detailed explanation, see Conlon (2005) 'Breaking up is hard to do: a guide for determining whether the distribution of another company's stock is taxable or tax-free' 2 Capital Changes In-Depth 7 (Capital Changes Reporter, 3rd November).
(44) See (2007) 'Tyco International Ltd. (New)', ADR/Global Capital Changes Reporter (Capital Changes Reporter, 5th July).
(45) Under Code §165, taxpayers may generally take a capital loss for stock when it becomes wholly worthless. The loss is only available for stocks and securities as defined under the applicable regulations, and some mortgage-backed securities do not qualify. Worthlessness must be established by reference to fixed and identifiable events, and there has often been litigation between the IRS and taxpayers regarding the proper year of taking the loss.
(46) See, generally, Treas. Reg. 1.165-5(c) and, eg, related discussion in *Jasinski v. Comm.*, TCM 1978-1 (3rd January, 1978).
(47) See, generally, Code §§1291-1298.
(48) See, eg, Code §1291(a)(1) and (a)(2).
(49) See generally Prop. Reg. 1.1291-6.
(50) See the definition of a PFIC set forth in Code §1297(a).