



## Tax Advisory

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### New Information Obligation For Corporate Actions Affecting Tax Basis

The ringing in of the New Year also marked the effective date of Section 6045B of the Internal Revenue Code (the "Code"). Originally part of the Energy Improvement and Extension Act of 2008, Section 6045B mandates a widespread return obligation for corporate actions affecting stock basis. It requires most domestic and foreign corporations (but not entities treated as partnerships) undertaking activities that affect the basis of their issued and outstanding stock to file an information return describing the action and the action's "quantitative effect" on the basis of each share of the outstanding stock – not solely stock issued on or after January 1, 2011. This information return must be filed on the earlier of forty-five (45) days after the date of the organizational action or January 15th of the following year. This means that for any organizational action, for example, occurring on January 31, 2011, the issuer must provide the information return no later than March 17, 2011. For many calendar year domestic and foreign corporations, this information return will be due before the corporation has filed its corporate income tax return and before the "quantitative effect" has been determined.

Specifically, Section 6045B requires an issuer of a "specified security" to make an information return setting forth: (1) a description of any organizational action that affects the basis of the specified security of the issuer, (2) the quantitative effect on the specified security's basis resulting from the organizational activity, and (3) any other information the Internal Revenue Service (the "IRS") may prescribe. In 2011, a "specified security" includes stock in a corporation (including a real estate investment trust, but not a regulated investment company). However, as it currently stands, beginning January 1, 2013, the term "specified security" will also include any note, bond, debenture, or other evidence of indebtedness, whether issued by a corporation or non-corporate entity.

The statute's broad scope extends to publicly traded securities as well as privately held securities and extends to transactions ranging from mergers, recapitalizations, and stock splits to spinoffs among others. The statute's reporting obligations also apply to dividend distributions in excess of "earnings

and profits” for tax purposes (“E&P”), which may inevitably force companies to update their E&P calculations annually. Private equity firms likely have investments in a number of corporate portfolio companies to which these new reporting obligations apply. Further, the reporting obligations under Section 6045B can extend beyond the issuing entity itself. The acquiring or successor entity of an issuer that fails to satisfy the reporting obligations discussed here must satisfy the reporting obligations itself or may be jointly and severally liable for any applicable penalties.

Although the statute's language requires the filing of an information return (and the regulations reference one), the IRS has not issued, and may not issue, a specific form for this purpose. Regardless of whether the IRS issues such form, the regulations instruct that the issuer return should include the following information: (1) the name and taxpayer identification number of the reporting issuer, (2) the identifiers of each security involved, (3) the contact information of the issuer, (4) information about the organizational action taken, and (5) the quantitative effect of the organizational action on the basis of the security.

The quantitative effect may be disclosed as an adjustment per share or as a percentage of the old basis, including a description of the calculation, the applicable Code provision upon which the tax treatment is based, the data supporting the calculation (including the market value of securities and valuation dates) and any other information necessary to implement the adjustment. However, precisely what the IRS means by the “quantitative effect” of an action is the subject of much debate. Some commentators have suggested that this provision merely requires a corporation to establish a mechanical adjustment by which each holder can determine the effect on basis such that an issuer is not required to show the precise basis adjustment that applies to every lot of every holder. The means of establishing the quantitative effect, among other items within new Section 6045B, may only become clear over time as corporations implement these new reporting requirements.

As a substitute for filing an information return, an issuer may post a return with the required information on its website provided that the information is accessible on its website for ten years from the applicable due date of the return. Further, when a corporation cannot determine the stock basis effect of a corporate action by the applicable due date of the return, the corporation must make reasonable assumptions to establish the reported effect, which can be corrected once the corporation determines the true effect. That being said, there is no cutoff date for corrected returns, meaning that if the true basis implications of a transaction are determinable some time down the road, the corporation has an ongoing obligation to disclose such findings on a corrected return.

S corporations, regulated investment companies and real estate investment trusts are subject to specific reporting procedures and effective dates under new Section 6045B. Further, there is an exemption wherever all of the holders of the corporate stock are “exempt recipients,” such as corporations or nonprofit organizations.

Failure to comply with the reporting requirements of Section 6045B may result in the imposition of penalties pursuant to Sections 6721 through 6724 of the Code. The penalties, which as a general matter include a \$50 penalty for each return (not to exceed \$250,000) that is not filed or does not include the required information, are due unless the failure to comply is the result of reasonable cause and not willful neglect.

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