

## IRS Final Cost Basis Regulations – Issuer Corporate Action Reporting

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On Oct. 12, 2010, the IRS issued the final cost basis reporting regulations (TD 9504) and related Notice 2010-67 (the Final Regs and the Notice—both documents are available at [www.costbasisreporting.com](http://www.costbasisreporting.com)). The Final Regs do not delay any of the effective dates relating to cost basis reporting and almost all of the key aspects of the proposed rules that create compliance complexities for brokers and cost basis systems were retained. However, some transferors of stock may delay transfer reporting due to IRS penalty relief set forth in Notice 2010-67 (the scope of the penalty relief is discussed in a separate article dated Oct. 15, 2010 available at [www.costbasisreporting.com](http://www.costbasisreporting.com)).

The cost basis law and the Final Regs include a number of different sets of rules. The core set of rules requires brokers (and applicable persons subject to transfer reporting) to make two key sets of basis adjustments under the cost basis reporting law and the Final Regs—basis and holding period adjustments in connection with corporate actions affecting securities and adjustments and loss deferrals relating to wash sales. Basis and holding period adjustments relating to corporate actions and wash sales can be complex and require tracking issuer corporate actions returns and data, and buy and sell activity. A key new aspect of the Final Regs is that a broker or transferor must make corporate action adjustments only for the period they hold a covered security.

In order to provide for consistent and correct booking of corporate actions related basis adjustments, the new cost basis reporting law (Internal Revenue Code Sec. 6045B) requires issuers of specified securities to report the “quantitative effect on basis” of corporate actions to the IRS generally within 45 days of the date of the corporate action and to holders of the securities no later than Jan. 15 of the following calendar year on a new information return (the IRS has not yet released a version of the new information return). The law and the Final Regs permit issuers to report the required information on a public website of the issuer as an alternative to filing returns with the IRS and providing statements to holders.

Brokers and transferors are required to adjust cost basis of securities based on issuer corporate action reporting. If a broker or transferor receives (or is deemed to receive per a public website) an issuer corporate action statement after the broker reports the sale of a security or a transferor provides a transfer statement, a corrected Form 1099-B must generally be provided within 30 days (and a transferor must generally provide a corrected transfer statement within fifteen days) of receiving the issuer statement. The Final Regs provide a cutoff date so that corrected Form 1099s do not need to be provided more than three years after the date originally filed (and corrected transfer statements do not need to be provided more than 18 months after the original transfer statements were delivered).

If an issuer statement is not provided or is incomplete, brokers may optionally adjust basis for corporate actions and there is penalty relief. There are concerns regarding whether brokers and transferors will receive issuer corporate action statements from issuers of foreign stocks and securities. The preamble to the Final Regs notes that brokers are not obligated to report foreign corporate actions if no issuer corporate action statement is provided or available and that if brokers optionally report such foreign corporate actions based on other information there is generally penalty relief provided that the broker neither knows or has reason to know that information provided from a third party is incorrect.

The proposed cost basis regulations would have required the issuer of specified securities to assign a unique identification number when reporting a corporate action (Corporate Action ID). Transferors would have been required to identify the Corporate Action ID relating to the last corporate action that they had processed on the transfer statement delivered upon transferring securities to another broker. There was substantial criticism of this proposal. The Final Regs eliminate the Corporate Action ID and accordingly also eliminate the requirement that transfer statements include the relevant Corporate Action ID. Part of the reason for eliminating this requirement is that under the Final Regs both brokers and transferors must adjust the cost basis of covered securities for corporate actions that are reported during the period they hold such securities. It should be noted that



due to the elimination of the Corporate Action ID it is possible there may be confusion among brokers and transferors as to whether a particular corporate action has been processed if a corporate action occurs during the time a security is transferred.

Set forth below is our top 10 list of issuer corporate action reporting related changes and retained rules in the Final Regs:

1. Corporate Action ID eliminated.
2. No draft return released (the IRS has not yet released a draft of the issuer corporate action reporting return form) and the reporting requirement applies for corporate actions beginning on or after Jan. 1, 2011.
3. No central repository—some securities market participants had suggested that the IRS appoint a central repository to track corporate actions data. This suggestion was not adopted.
4. Public company website alternative to reporting with data accessible for 10 years.
5. Corporate action can be determined based on reasonable assumptions before due date.
6. Corrected issuer corporate action return must be filed within 45 days of any change that impacts the basis reported.
7. Treatment of dividend payments for corporate action reporting purposes must be consistent with 1099-DIV reporting.
8. No reporting to exempt recipients or by regulated investment company (RIC) money market funds.

9. Statements must be delivered to holders of record, including nominees by Jan. 15 of following year. This is a concern and will likely lead to corrected cost basis and transfer statement reporting because brokers typically adjust for corporate actions no later than the day the corporate action occurred.

10. Unlike the rules for Form 1099-B cost basis reporting by brokers and transfer statement reporting, the issuer corporate action reporting rules do not include any cutoff date. Thus, an issuer would be required to file corrected issuer corporate action returns at any time if facts change that affect the quantitative effect on cost basis reported.

Other changes: if the issuer of securities is acquired, the acquirer of the issuer becomes responsible for the issuer's reporting obligations; limited "eyeball test" for exempt corporate holders; S corporation return K-1 alternative; undistributed RIC & REIT capital gains that are reported on Form 2438 & 2439 do not need to be reported on an issuer corporate action return; an issuer can use an agent to comply with issuer corporate action reporting requirement but the issuer is responsible for any penalties.

There are a number of other important rules in the Final Regs that address issues such as the rules for lot selection and averaging of basis for mutual fund and dividend reinvestment plan shares, required basis and holding period adjustments, the definition of covered securities, rules for short sales, and transfer reporting. Issues relating to these rules under the Final Regs will be discussed separately.

We will provide additional commentary relating to the Final Regs and other aspects of the cost basis reporting law at later dates.

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