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New Form 8937 Requires Reporting of Stock Basis

The IRS recently issued the final version of Form 8937, Report of Organizational Actions Affecting Basis of Securities and instructions, requiring issuers that engage in organizational actions that affect the basis of a specified security to provide certain information to the IRS.

The IRS on January 5 released Form 8937, *Report of Organizational Actions Affecting Basis of Securities*, as well as the related instructions. The form requires an "issuer" to provide certain information to the IRS if it engages in an "organizational action" during the year that affects the basis of "specified securities." The reporting requirement became effective for transactions taking place on or after January 1, 2011.

In general, the returns are due within 45 days after a corporation closes a transaction that affects the basis of all security holders if the securities are held by U.S. non-exempt shareholders, such as individuals, partnerships, LLCs, and trusts. Thus, private companies with U.S. individual shareholders should analyze the reporting requirements and act quickly to ensure that they are in compliance with the new reporting requirements.

Background

New code section 6045B was enacted as part of the Energy Improvement and Extension Act of 2008. Section 6045B requires issuers to provide the quantitative effect on the basis of a specified security resulting from an organizational action. The new reporting requirements are designed to assist brokers and others in adjusting a shareholder's basis over time so that gain or loss can be properly calculated and reported upon sale.

Specified Securities

A "specified security" generally is defined as any share of stock in an entity (U.S. or non-U.S.) organized as a corporation for federal tax purposes, including any interest treated as stock, such as an American Depository Receipt. After January 1, 2013, this definition could be expanded to include notes, bonds, debentures and commodities or any other security identified by Treasury or the IRS. The requirement to file Form 8937 applies to both U.S. and non-U.S. public and private corporations.

Organizational Actions

The term "organizational action" is not clearly defined in the statute or regulations, but the legislative history and Treasury commentary refer to stock splits, mergers, and acquisitions as examples of reportable transactions. The examples in the regulations also include stock distributions and cash distributions in excess of corporate earnings and profits.

In general, nontaxable transactions that affect the stock basis of all security holders or all holders of a class of security are most likely to trigger section 6045B reporting. Thus, any actions resulting in sale or exchange treatment (for example, redemptions or distributions in complete liquidation) are generally not reportable on Form 8937 because such transactions result in the sale or cancellation of shares and the elimination of basis, rather than an adjustment to basis. Similarly, transactions that create or establish basis (such as the issuance of stock in a public stock offering) generally are not reportable transactions because they do not result in a change in basis. In contrast, actions that affect stock basis, such as distributions in excess of earnings and profits or tax-free mergers and acquisitions that result in the transfer of historic basis from the relinquished stock to the replacement stock, are reportable for purposes of section 6045B.

Reporting Requirements

If an issuer engages in an organizational action that affects the basis of its stock, it must file Form 8937 with the IRS within 45 days of the close of the action (or, if earlier, January 15 of the following calendar year). The issuer also must furnish corresponding statements to each nominee of the stockholder (or to each stockholder if there is no nominee) by January 15 of the following calendar year.

Public reporting

Although it may not be practical for many private companies, issuers may post the Form 8937 to their primary public website in lieu of filing the return with the IRS and furnishing statements to all non-exempt shareholders and nominees. The information must be posted in a "readily accessible format" and remain accessible to the public for 10 years.

Exceptions

Exempt recipients

Reporting is not required if the issuer's shareholders are all "exempt recipients." For purposes of section 6045B, exempt recipients are tax-exempt organizations, corporations (excluding S corporations after January 1, 2012), governments, individual retirement accounts (IRAs), documented or presumed non-U.S. payees, foreign central banks of issue, REITs, RICs, securities and commodities dealers, and financial institutions.

Accordingly, if the issuer has both exempt and non-exempt recipients, it will need to file a return with the IRS but will need to furnish statements only to the non-exempt recipients.

Action must affect all shareholders

A reporting obligation exists under section 6045B only if the organizational action affects the basis of all holders of a security or all holders of a class of security.

Thus, the exercise of an incentive stock option or the redemption of a single shareholder's stock is not the type of transaction that is reportable, because it does not affect the basis of all shareholders.

S corporations

An issuer organized as an S corporation is deemed to satisfy the reporting requirements of section 6045B for any organizational 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), *Shareholder's Share of Income, Deduction, Credit, etc.*

What Needs To Be Reported

Form 8937 requires detailed information that may result in significant burdens to private companies if they have insufficient resources to track the required information. For example, Form 8937 requires the following information:

1. The classification and description of the security as well as the relevant security identifiers (CUSIP number, serial number, ticker symbol, account number);
2. A description of the organizational action, and, if applicable, the date of the action or the date against which shareholders' ownership is measured for the action;
3. Quantitative effect of the organizational action(s) on the basis of the security in the hands of a U.S. taxpayer as an adjustment per share or as a percentage of old basis;
4. Description of the calculation of the change in basis and the data that support the calculation, such as the market values of securities and the valuation dates;
5. List of the applicable Internal Revenue Code section(s) and subsection(s) upon which the tax treatment is based;
6. Admission of any resulting loss that can be recognized; and
7. Any other information necessary to implement the adjustment, such as the reportable tax year.

Reasonable Assumptions

An issuer may make "reasonable assumptions" to meet the filing deadline if information is not readily available. However, if the issuer subsequently determines that its assumptions were not correct, it will need to file an amended return within 45 days of the determination.

Failure to File Penalty

Issuers that fail to comply with these filing requirements may be subject to the failure to file and failure to furnish penalties under sections 6721 and 6722. Generally, there is a $100 penalty per return (with a maximum penalty of $1.5 million) and a separate $100 penalty per shareholder statement ($1.5 million maximum per year). Alternatively, the IRS could impose a $250 penalty per return if it determines that the failures were willful or due to intentional disregard of the rules (that is, a finding of gross negligence). The assessment for intentional disregard also has a 10-percent penalty that would apply to the amount required to be shown if it is greater than the $250-per-form penalty. However, Form 8937 reports the impact that an organizational action has on particular shareholders as opposed to reporting particular income or payment amounts. Consequently, it is uncertain how the IRS could apply the 10-percent portion of the penalty.

Special Rule on the Reporting of 2011 Organizational Actions

On January 13, the IRS announced in Notice 2012-11 that it would provide penalty relief for issuers that made a "good faith" effort to post or file the required information by the due date. However, the transitional relief is limited to organizational actions occurring in 2011.

Acquiring and Successor Entities

In the event an issuer is subsequently acquired, the acquiring or successor entity must satisfy the reporting obligations if the issuer failed to do so. If neither the acquiring nor successor entity of an issuer satisfies the reporting obligations, both parties may be held jointly and severally liable for any applicable penalties.

How PwC can help

The new Form 8937 is likely to create additional compliance burdens for private companies, which will need to calculate and track adjustments to basis resulting from corporate transactions. Private companies should evaluate their past and future organizational actions to determine if they are subject to the new reporting requirements. PwC can assist taxpayers with identifying reportable transactions and determining the basis of specified securities through advanced cost basis analysis and data reconciliation. PwC also can help with the reporting obligations associated with the new requirements.

For more information, please do not hesitate to contact:

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