

Section 6045B



January 2011

Information reporting rules for organizational actions affecting the basis of specified securities on or after January 1, 2011.

Background

Section 6045B, enacted as part of The Energy Improvement and Extension Act of 2008, provides that an issuer of a specified security must report certain information to the IRS following an organizational action that affects the basis of the specified security. For purposes of section 6045B, a specified security can include, but is not limited to, any share of stock in a corporation, any note, bond, debenture, or other evidence of indebtedness. The issuer must set forth a description of the organizational action which affects the basis of such specified security of the issuer and the quantitative effect on the basis of the specified security resulting from the action. This reporting is required for transactions occurring on or after January 1, 2011. It also provides that an issuer must also furnish a separate written statement to each holder of record of the security or its nominee as of the date of the organizational action. These rules apply to both public and private companies, whether foreign or domestic.

Under section 6045B, taxpayers must comply with the reporting requirements within 45 days after the action, but in any case no later than January 15 of the following calendar year. This can be accomplished by filing the required information with the IRS and furnishing a separate written statement to each holder of record. In the alternative, the taxpayer can post the required information in a readily accessible format on the taxpayer's website, providing accessibility to the public for a period of ten years after the date of posting. A taxpayer is deemed to satisfy both reporting requirements if a

taxpayer posts the required information on its website by the due date described above.

On October 12, 2010, the IRS issued regulations providing issuers with insight into what type of transactions will be deemed to be organizational actions. In general, the regulations provide no specific definition of organizational action; however the legislative history and final regulations provide examples of actions that affects the basis of a security in the hands of a shareholder that must be reported in accordance with section 6045B. These actions would presumably include mergers, spin-offs, stock splits, stock redemptions, and distributions in excess of corporate earnings and profits, if these actions affect the basis of a specified security.

These regulations also listed the information required to be reported to include (1) the name and taxpayer identification number of the reporting issuer; (2) identifiers of each security involved in the organizational action including the security's CUSIP number or other security identifier number; (3) the name, address, e-mail address, and telephone number of a contact person at the issuer; (4) the type or nature of the organizational action including, as applicable, the date of the action or the date against which shareholders' ownership is measured for the action; and (5) the quantitative effect of the organizational action 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, including a description of the calculation, the applicable Internal Revenue Code section and subsection upon which the tax treatment is based, the data supporting the

calculation such as the market values of securities and valuation dates, any other information necessary to implement the adjustment including the reportable taxable year, and whether any resulting loss may be recognized.

Observations

Exceptions to reporting

The regulations under section 6045B provide that reporting to the IRS and shareholders of record or its nominee is not required if the recipient is deemed to be an "exempt recipient." Exempt recipients include (1) corporations, whether domestic or foreign; (2) an organization exempt from taxation under section 501(a) or an individual retirement plan; (3) the United States or a State, the District of Columbia, a possession of the United States, or a political subdivision; (4) a foreign government, a political subdivision thereof, or an international organization; (5) a foreign central bank of issue; (6) a dealer in securities or commodities registered as such under the laws of the United States or a State; (7) a futures commission merchant registered as such with the Commodity Futures Trading Commission; (8) a real estate investment trust, as defined in section 856; (9) an entity registered at all times during the taxable year under the Investment Company Act of 1940; and (10) a common trust fund. In addition, the regulations also provide that no reporting is required if the issuer reasonably determines that all of the holders of the security are exempt recipients as indicated above.

A regulated investment company or real estate investment trust that reports undistributed capital gains to shareholders under section 852(b)(3)(D) or 857(b)(3)(D) is deemed to have met the reporting requirements of section 6045B for purposes of the undistributed capital gain distribution by filing Form 2438, Undistributed Capital Gain Tax Return, and Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains.

Other issues and pitfalls

Commentators on the proposed regulations requested for the reporting requirements of section 6045B to be coordinated with the reporting requirements of certain changes in corporate control and capital structure under section 6034(c), however this relief was not adopted in the final regulations, providing issuers with a possible duplicated reporting requirement for corporate actions under both section 6043(c) and 6045B. The Treasury indicated that reporting on Form 1099-CAP, Changes in Corporate Control and Capital Structure, and Form 8806, Information Return for Acquisition of Control or Substantial Change in Capital Structure, does not include all of the information required under section 6045B.

The regulations permitted issuers to make reasonable assumptions about facts that have a quantitative affect on basis that cannot be determined prior the reporting due date. This can have a potential impact on real estate investment trusts which make distributions in excess of corporate earnings and profits on a regular basis due to excess depreciation deductions. An issuer must treat a distribution that may be a dividend as such, thus creating no reporting requirement under section 6045B, until obtaining facts that result in a different quantitative effect on basis. An issuer has 45 days from the date of obtaining this information to report the impact of the action in accordance with section 6045B if a distribution is deemed to be a return of capital. The failure of an issuer to report under section 6045B after obtaining facts that result in a quantitative impact on the basis of the issuer's securities within the time prescribed may result in the entire distribution being deemed a dividend, subject to current taxation at the shareholder level. These requirements may result in the need for a corporation to revisit projections of earnings and profits more frequently.

The overall affect on a specific shareholder's basis may vary in certain transactions, particularly in mergers or other corporate action in which

shareholder may receive boot. Although it is not clear whether or not the quantitative affect on basis would have to be reported separately in such cases, complying with the reporting requirements via a corporate website appears to permit issuers to present the overall mechanics of the basis adjustment as a whole, as an issuer is not required to provide individual shareholders of record or their nominees with a separate written statement.

A practical solution to complying with Section 6045B

Although section 6045B and the regulations refer to a return, the IRS has yet to release a form in connection with the reporting requirements, and it is currently unclear whether or not the IRS will issue one. It is advisable that issuers implement policies and procedures that permit them to comply with the reporting requirements of section 6045B. Failure to comply with the reporting requirements of section 6045B may subject an issuer to penalties of \$100 per failure. These penalties are assessed on each failure to file with the IRS and each failure to report the required information to each holder of record. Posting the required information on the issuer's primary public website may provide issuers with the easiest method for complying with these requirements. However, the provisions of section 6045B could place significant reporting obligations on private companies without public websites. Taxpayers should also be mindful of any activities undertaken that could be considered "organizational actions" affecting the basis of specified debt and equity securities so that the required returns under section 6045B can be submitted by their applicable due dates.

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