

Part III - Administrative, Procedural, and Miscellaneous

Stock Basis

NOTICE 2011-56

PURPOSE

This notice provides interim guidance under § 1012 of the Internal Revenue Code on issues relating to the basis of stock.

BACKGROUND

Under § 1.1012-1(e) of the Income Tax Regulations, taxpayers may use the average basis method to determine the basis of stock in a regulated investment company (RIC). Section 403 of the Energy Improvement and Extension Act of 2008, Div. B of Pub. L. No. 110-343, 122 Stat. 3765 (the Act), amended § 1012 to allow taxpayers to average the basis of stock acquired after December 31, 2010, in connection with a dividend reinvestment plan (DRP), as well. A taxpayer that does not use the average basis method determines the basis of stock under § 1012(a) by its cost.

The Act also amended § 6045 to require brokers to report, upon the sale of stock, adjusted basis of the stock sold and whether gain or loss is long-term or short-term, effective generally for stock acquired after December 31, 2010, and for RIC or DRP stock acquired after December 31, 2011.

Final regulations implementing these amendments were published on October 18, 2010, T.D. 9504, 75 F.R. 64072, 2010-47 I.R.B. 670. Thereafter, public

stakeholders requested clarification or raised new issues. The Internal Revenue Service and Treasury Department intend to publish proposed regulations addressing some of these issues. Taxpayers may rely on the guidance provided in this notice pending publication of superseding guidance.

INTERIM GUIDANCE

Change from Broker Default Average Basis Method

A stakeholder suggested that, when a taxpayer changes from a broker's default average basis method to the cost basis method, the basis of the shares should revert to the cost basis under certain circumstances.

Section 6045(g)(2)(B)(i)(II) provides that, for purposes of broker reporting, the adjusted basis of RIC or DRP stock is determined by a broker's default method unless a taxpayer elects another method. Section 1.1012-1(e)(2)(i) provides that, unless a taxpayer elects another method, the basis of RIC or DRP stock is determined by the broker's default method.

Section 1.1012-1(e)(9)(i) provides that, beginning in 2012, a taxpayer elects the average basis method by notifying a broker in writing. Under § 1.1012-1(e)(9)(iii), a taxpayer that wants to revoke its average basis method election must revoke the election within one year after making the election or, if earlier, by the date of the first disposition of the stock. A broker may extend the one-year period but not beyond the first disposition of the stock. After a revocation, the basis of the stock reverts to the cost basis.

After the revocation period has expired, a taxpayer may change from the average basis method to the cost method at any time, but only for stock acquired after the date

of the change (the change is prospective). After the change, the basis of the stock that was averaged remains averaged. Section 1.1012-1(e)(9)(iv).

Section 1.1012-1(e)(9)(i) provides that a taxpayer has not made a basis election if (1) the taxpayer fails to choose a basis determination method, and (2) basis is determined by a broker's default method. Section 1.1012-1(e)(9)(v), Example 2, illustrates that, because averaging under a broker's default method is not a taxpayer's election, a taxpayer's change from a broker's default averaging method to the cost method is prospective and stock acquired before the change retains the averaged basis.

To provide consistency between revoking a taxpayer's average basis election and changing from a broker's default average basis method, the proposed regulations are expected to provide that, when a taxpayer changes from a broker's default averaging method for RIC or DRP stock to the cost basis method, the basis of the stock reverts to the cost basis if the taxpayer requests the change by the earlier of (1) one year after receiving notice of the broker's default method, or (2) the date of the first sale, transfer, or other disposition of the stock. A broker may extend the one-year period, but not later than the date of the first sale, transfer, or disposition of the stock.

To determine the beginning of the one-year period, a broker using the average basis method as a default method must use reasonable means to notify taxpayers. Reasonable means may be mailings, circulars, or electronic mail sent separately or included in a taxpayer's account statement, or other means reasonably calculated to provide actual notice. The notice must identify the securities subject to the broker's default average basis method.

Ten Percent Reinvestment Rule and Fractional Shares

Under § 1012(d)(4)(A), a DRP is an arrangement under which dividends are reinvested in identical stock. Section 1.1012-1(e)(6)(i) provides that a plan, arrangement, or program qualifies as a DRP if the written plan documents require that at least 10 percent of every dividend on any share of stock is reinvested in identical stock.

A stakeholder asked if a plan that pays only cash in lieu of fractional shares meets the 10 percent requirement if the dividends on some shareholders' stock are insufficient to acquire at least one whole share of identical stock. For example, if a shareholder in a plan receives a dividend of \$30.00 but the price of one share of stock exceeds \$30.00, the shareholder will not be able to reinvest 10 percent and will receive the dividend in cash.

It is expected that the proposed regulations will clarify that a DRP does not fail the 10 percent reinvestment requirement because it pays cash in lieu of fractional shares when the amount of a dividend is insufficient for some shareholders to acquire stock.

Lot Selection Methods Across Accounts

Section 1012(c)(1) provides that the "conventions" prescribed in the § 1012 regulations apply to stock disposed of after certain dates on an account-by-account basis. The legislative history identifies these "conventions" as first-in, first-out (FIFO), specific identification, and average basis. H. Rep. No. 606, 110th Cong., 2d Sess. 62 (2008). However, § 1.1012-1(e) provides account-by-account rules only for averaged stock. The proposed regulations are expected to clarify that the lot selection methods,

such as FIFO and specific identification, also apply on an account-by-account basis.

REQUEST FOR COMMENTS

Comments are requested on issues arising under this notice. Comments should be submitted in writing on or before August 8, 2011, and should include a reference to Notice 2011-56. Comments may be submitted to CC:PA:LPD:PR (Notice 2011-56), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, or electronically to Notice.Comments@irs.counsel.treas.gov. Please include "Notice 2011-56" in the subject line of any electronic communications.

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2011-56), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. All comments are available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this notice are Amy Pfalzgraf and Edward C. Schwartz of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, please contact Mr. Schwartz at (202) 622-4960 (not a toll-free call).