

## Understanding the Transactions after a Cash/Stock Merger

Corporations sometimes create merger transactions that exchange both cash and shares of one stock for the shares of a currently held stock. These exchanges can generate taxable gain if the amount of the received security and cash exceeds the cost basis of the originally held security. Use the Cash Proceeds settings in the PortfolioCenter Merger/Exchange Wizard to accurately generate the transactions. This document explains the calculations you might see when using the Merger/Exchange Wizard's Cash Proceeds settings.

When exchanging one security for shares of another security plus cash, there are three possible transaction combinations to handle the cash portion of the exchange:

- ◆ All Long or Short Term Gain Distribution transactions – you get these transactions when the gain on the exchange is greater than the cash received. The key to these transactions is, although the gain is greater than the cash, the maximum amount of the cash transaction is the number of shares of the old position times the cash distribution.
- ◆ Some Long or Short Term Gain Distribution Transactions, some ROP transactions – you get this combination of transactions when the gain of the exchange is less than the cash received. The amount of the gain is represented by the long or short term gain distribution, while the difference between total cash received and gain is captured in the ROP.
- ◆ ROP Transactions only – you get these transactions when the cost basis of the security you are giving up is greater than the combination of cash and market value of the security you are getting in exchange. Again, although the amount of the exchange is less than the cost basis, the ROP in this situation is always going to be the number of shares of the original position multiplied by the cash distribution.

All transactions created by the wizard are separated by trade lot, so it is possible to see all three scenarios described above in a single portfolio. For simplicity, we are going to demonstrate only one scenario for all trade lots in each example.

### Original Position Information in Example

Let's consider the account below with three trade lots of Original Security. Let's also assume that the exchange with New Security occurs on 9/30/08. This means we have two trade lots that are Long Term, one that is short term. The trade lot information is described below:

- ◆ 6/15/06: 100 shares with cost of \$3,200
- ◆ 6/15/07: 100 shares with cost of \$2,800
- ◆ 6/15/08: 100 shares with cost of \$3,000

Total Cost Basis is \$9,000.

In the exchange, the portfolio will receive .75 share for each original share, or 225 shares total.

Asset Position Statement				
As of 09/30/2008				
Holly Brown	Equity - Education Trust	Acct #: 999-0202		
Description	Trade Date	Quantity	Cost Basis	Unit Cost
<b>Equities</b>				
Original Security	06/15/2006	100	3,200.00	32.000
Original Security	06/15/2007	100	2,800.00	28.000
Original Security	06/15/2008	100	3,000.00	30.000
		300	9,000.00	

## Gain greater than cash:

First, let's assume an exchange where the gain is greater than cash. In this situation, we are getting 225 shares valued at \$11,999.25 (225 new shares x \$53.33 fair market value), plus \$3,000 in cash. (300 original shares x \$10/share) giving us a total value of the exchange of \$14,999.25.

The gain for the exchange is \$5,999.25 (\$14,999.25 in cash and stock - \$9,000 cost basis).

Because the gain of \$5,999.25 is greater than the \$3,000 received in cash, the cash stock merger produces only gain distribution transactions. See the image below for examples:

	Status	Account Number	Portfolio	Activity	Report As	Symbol	Trade Date	Amount
1	Pending	999-0202	Brown, Holly	Credit		NEWSCTY	09/01/2008	3,200.00
2	Pending	999-0202	Brown, Holly	Credit		NEWSCTY	09/01/2008	2,800.00
3	Pending	999-0202	Brown, Holly	Credit		NEWSCTY	09/01/2008	3,000.00
4	Pending	999-0202	Brown, Holly	Income	Long Term Gain	NEWSCTY	09/01/2008	1,000.00
5	Pending	999-0202	Brown, Holly	Income	Long Term Gain	NEWSCTY	09/01/2008	1,000.00
6	Pending	999-0202	Brown, Holly	Income	Short Term Gain	NEWSCTY	09/01/2008	1,000.00
7	Pending	999-0202	Brown, Holly	Debit Sec		ORIG	09/01/2008	

However, the calculations above only take the entire position into consideration. Let's see how it looks when you break out the calculation by trade lot:

Trade Lot	Cost Basis of Lot	Value of Exchange	Variance	Amt of Gain Trn
6/15/06 Long Term	\$3,200	\$3,999.75 + \$1,000 = \$4,999.75	\$4,999.75 - \$3,200 = \$1,799.75	\$1,000 (cash received)
6/15/07 Long Term	\$2,800	\$3,999.75 + \$1,000 = \$4,999.75	\$4,999.75 - \$2,800 = \$2,199.75	\$1,000 (cash received)
6/15/08 Short Term	\$3,000	\$3,999.75 + \$1,000 = \$4,999.75	\$4,999.75 - \$3,000 = \$1,999.75	\$1,000 (cash received)
<b>Total Position</b>	<b>\$9,000</b>	<b>\$11,999.25 + \$3,000 = \$14,999.25</b>	<b>\$14,999.25 - \$9,000 = \$5,999.25</b>	<b>\$3,000 (cash received)</b>

## Gain less than cash

Now, let's assume the amount of the gain was less than the cash received. You should still get Long and Short Term gain distributions for the total cash received, but you will also get ROP transactions to "offset" the difference between the cash received and the amount of the gain.

In this situation, we are getting 225 shares valued at \$6,000.75 (225 new shares x \$26.67 fair market value), plus \$9,000 in cash. (300 original shares x \$30/share) giving us a total value of the exchange of \$15,000.75.

The gain for the exchange is \$6,000.75 (\$15,000.75 in cash and stock - \$9,000 cost basis).

Because the gain of \$6,000.75 is less than the \$9,000 received in cash, the cash stock merger produces both gain distribution transactions and ROP transactions. The gain distribution transactions account for the amount of the gain (difference between exchange value and cost basis) while the ROP amounts account for the difference between the gain and total cash received. See the image below for examples. The table below the image explains the calculation of gain and ROP for each trade lot.

	Status	Account Number	Portfolio	Activity	Symbol	Report As	Trade Date	Description	Amount	Quantity	Security Type	Error	Account ID	Brok
1	Pending	999-0202	Brown, Holly	Credit	NEWSCTY		09/01/2008	New Security	3,200.00	75.00	Equities			
2	Pending	999-0202	Brown, Holly	Credit	NEWSCTY		09/01/2008	New Security	2,800.00	75.00	Equities			
3	Pending	999-0202	Brown, Holly	Credit	NEWSCTY		09/01/2008	New Security	3,000.00	75.00	Equities			
4	Pending	999-0202	Brown, Holly	Income	NEWSCTY	Long Term Gain	09/01/2008	New Security	1,800.25	0.00	Equities		CASH	
5	Pending	999-0202	Brown, Holly	Income	NEWSCTY	Long Term Gain	09/01/2008	New Security	2,200.25	0.00	Equities		CASH	
6	Pending	999-0202	Brown, Holly	Income	NEWSCTY	Short Term Gain	09/01/2008	New Security	2,000.25	0.00	Equities		CASH	
7	Pending	999-0202	Brown, Holly	ROP	NEWSCTY		09/01/2008	New Security	1,199.75		Equities		CASH	
8	Pending	999-0202	Brown, Holly	ROP	NEWSCTY		09/01/2008	New Security	799.75		Equities		CASH	
9	Pending	999-0202	Brown, Holly	ROP	NEWSCTY		09/01/2008	New Security	999.75		Equities		CASH	
10	Pending	999-0202	Brown, Holly	Debit Sec	ORIG		09/01/2008	Original Security		300.00	Equities			

  

Security Type	Equities
Activity	Income
Account Number	999-0202
Portfolio	Brown, Holly
Symbol	NEWSCTY
Security Description	New Security
Pay Date	09/01/2008
Ex Date	
Income Amount	1,800.25
Distribution Type	Long Term Gain
Reinvested Shares	0.00
Account ID	CASH
Normal Income	Yes
Taxable Prev. Year	No
Pay on Positions	Long
Amount Per Share	0.00
Trade Status	Pending
Entry Date	11/19/2008
Notes	Original/New cash/stoc

<u>Trade Lot</u>	<u>Cost Basis of Lot</u>	<u>Value of Exchange</u>	<u>Variance</u>	<u>Amt of Transactions</u>
6/15/06 Long Term	\$3,200	\$2000.25 + \$3,000 = \$5,000.25	\$5,000.25 - \$3,200 = \$1800.25	\$1,800.25 (LT Gain)
ROP is difference of gain & Cash:		\$3,000 (cash) - \$1,800.25 (gain) =		\$1,199.75 (ROP)
<b>Cash for this trade lot:</b>		<b>\$1,800.25 + \$1,199.75</b>		<b>= \$3,000.00</b>
6/15/07 Long Term	\$2,800	\$2000.25 + \$3,000 = \$5,000.25	\$5,000.25 - \$2,800 = \$2,200.25	\$2,200.25 (LT Gain)
ROP is difference of gain & Cash:		\$3,000 (cash) - \$2,200.25 (gain) =		\$799.75 (ROP)
<b>Cash for this trade lot:</b>		<b>\$2,200.25 + \$799.75</b>		<b>= \$3,000.00</b>
6/15/08 Short Term	\$3,000	\$2000.25 + \$3,000 = \$5,000.25	\$5,000.25 - \$3,000 = \$2,000.25	\$2,000.25 (ST Gain)
ROP is difference of gain & Cash:		\$3,000 (cash) - \$2,000.25 (gain) =		\$999.75 (ROP)
<b>Cash for this trade lot:</b>		<b>\$2,000.25 + \$999.75</b>		<b>= \$3,000.00</b>
<b>Total Position</b>	<b>\$9,000</b>	<b>\$6,000.75 + \$9,000</b> <b>= \$15,000.75</b>	<b>\$9000 - \$6,000.75</b> <b>= \$6,000.75</b>	<b>\$6,000.75</b> <b>(Gain)</b>  <b>\$2,999.25</b> <b>ROP</b>

## No gain on the transaction

Finally, let's assume the amount of the fair market value of the new security and cash received in the exchange is less than the cost basis of the original security. In this case, you only get ROP transactions in the amount of the cash received.

In this situation, we are getting 225 shares valued at \$5,625.00 (225 new shares x \$25.00 fair market value), plus \$2,400 in cash. (300 original shares x \$8/share) giving us a total value of the exchange of \$8,025.

The cost basis exceeds the exchange by \$975 (\$8025 in cash and stock - \$9,000 cost basis).

Even though there was no gain on the exchange, you still receive cash in the exchange. The wizard creates ROP transactions equal to the total amount of the cash distribution times the number of shares in the original position, as shown below.

Merger/Exchange Wizard - Merger Proceeds

Enter the information for the proceeds of the merger

Security Type: Equities

Symbol: NEWSCTY

Share Exchange Ratio: .75

Cash Proceeds:

Fair Market Value: 25.00

Cash Distribution Ratio: 8.00

Conversion price for cash in lieu of fractional shares: 0.01

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Cash/StockMerger - No gain										
Global Transactions										
	Status	Account Number	Portfolio	Activity	Symbol	Trade Date	Description	Amount	Quantity	Security Type
1	Pending	999-0202	Brown, Holly	Credit	NEWSCTY	09/01/2008	New Security	3,200.00	75.00	Equities
2	Pending	999-0202	Brown, Holly	Credit	NEWSCTY	09/01/2008	New Security	2,800.00	75.00	Equities
3	Pending	999-0202	Brown, Holly	Credit	NEWSCTY	09/01/2008	New Security	3,000.00	75.00	Equities
4	Pending	999-0202	Brown, Holly	ROP	NEWSCTY	09/01/2008	New Security	800.00		Equities
5	Pending	999-0202	Brown, Holly	ROP	NEWSCTY	09/01/2008	New Security	800.00		Equities
6	Pending	999-0202	Brown, Holly	ROP	NEWSCTY	09/01/2008	New Security	800.00		Equities
7	Pending	999-0202	Brown, Holly	Debit Sec	ORIG	09/01/2008	Original Security		300.00	Equities

  

Security Type	Equities
Activity	ROP
Account Number	999-0202
Portfolio	Brown, Holly
Symbol	NEWSCTY
Security Description	New Security
Date	09/01/2008
Amount	800.00
Account ID	CASH

See the table below for examples when broken out by trade lot.

Trade Lot	Cost Basis of Lot	Value of Exchange	Variance	Amt of ROP Trn
6/15/06 Long Term	\$3,200	\$1,875 + \$800 = \$2,675	\$2,675 - \$3,200 = \$(525)	\$800 (ROP)
6/15/07 Long Term	\$2,800	\$1,875 + \$800 = \$2,675	\$2,675 - \$2,800 = \$(125)	\$800 (ROP)
6/15/08 Short Term	\$3,000	\$1,875 + \$800 = \$2,675	\$2,675 - \$3,000 = \$(325)	\$800 (ROP)
<b>Total Position</b>	<b>\$9,000</b>	<b>\$ 5,625 + \$2,400 = \$8025</b>	<b>\$8025 - \$9,000 = \$(975)</b>	<b>\$800 (ROP)</b>