GAINSKEEPER
Keep your gains. Minimize your losses. Preserve your sanity.

What's a corporate action, and why would anyone care?

A corporate action is any event which brings material change to a stock. Splits are the most common corporate action, but there are many other examples, including mergers, acquisitions, and spin-offs. These changes are very common, occurring in the U.S. stock market up to 18,000 times per year. Here's an example of one such series of corporate actions. Believe it or not, the following is all true.

Let's say that, as the result of a great night's sleep at the Albuquerque Marriott in July 1993, you bought 300 shares of Marriott Corporation at $10/share.

On August 2, 1999 you decide to sell your Marriott position so that you can jump on the next big Internet IPO, motel.com. They don't actually have buildings, but you can go online and feel like you're in a hotel room (your favorite chat room says it's a can't miss stock!).

You go to your online brokerage and note that Marriott is trading at 10-3/8, so your expected windfall will be $112.50 (300 shares @ 3/8 per share). Easy, right? Not so fast. During the six years since you first bought Marriott Corporation, the following has occurred:

On October 8, 1993 the stock split into two securities, Host Marriott and Marriott International. Your original 300 shares is now 300 shares of Host Marriott and 300 shares of Marriott International, with a cost allocation of 18.797% and 81.203%, respectively. But that's not all...

On December 29, 1995 the Host Marriott shares split into 300 shares of Host Marriott Corporation (HMT) and 60 shares of Host Marriott Services (HMS), with cost allocations of 89.104% and 10.896, respectively. That's not 89.104% and 10.896% of the original 100% cost allocation, but of the Host Marriott spin-off (18.797% of the original cost). If you're not confused yet, read on.

On March 27, 1998 the Marriott International shares (remember them?) split into (a) 300 shares of Marriott International, Inc. Class A Common Stock, (b) 300 shares regular common stock, and (c) 75 shares of Sodexho Marriott Services. Two months later the common stock (b) was converted to Class A Common (a). The cost allocation of these new positions was 45.485%, 46.229% and 8.286% of the original Marriott International, Inc. (We're not making this stuff up.)

On December 29, 1998 Host Marriott Corporation (HMT) split into 300 shares of Host Marriott Corporation (HMT)[REIT] and 30 shares of Crestline Capital Corporation (CLJ). One hundred percent of the cost (of 89.104% of the 18.797 of the original cost) was allocated to HMT[REIT]. The Crestline shares were priced at $15.30/share, resulting in $459 of additional cost and a taxable dividend in 1998. (Hopefully you included that in your tax return.)

Finally, on February 10, 1999 Host Marriott Corporation (HMT)[REIT] paid a special dividend. Because this hasn't been complicated enough already, shareholders had the option of electing $1/share or .087 shares of HMT[REIT] common stock. If the shares were elected, you would have received 26.1 shares (26 shares issued, the fractional shares paid in cash) The cost of the whole shares was $11.84375/share, resulting in a total cost of $284.25 which was taxable as dividend in 1999. Or maybe it wasn't; you would have had to decipher the additional notes to determine if it was.

Remember those original 300 shares you purchased as the result of a sound night's sleep? The ensuing accounting nightmare has left you with the following:

300 shares of Host Marriott Corporation [REIT], cost basis of $502.47
60 shares of Host Marriott Services, cost basis of $61.44
600 shares of Class A Common Stock of "new" Marriott Int'l, Inc., cost basis of $2,234.24
75 shares of Sodexho Marriott Services, Inc., cost basis of $201.85
30 shares of Crestline Capital Corporation, cost basis of $459

The value of all the securities you went to sell on August 2, 1999 was $26,778.13. Nice return on your sale of Marriott, which is good because your accountant's bill for unwinding this mess would be very substantial.

Even if you had updated your positions every step of the way, this would not have been an easy or enjoyable experience. If GainsKeeper had existed in 1993 we would have saved you the trouble of adjusting your original tax basis in Marriott, as well as calculate your tax basis in all new holdings due to Marriott's splits, spin-offs and distributions. GainsKeeper would have even calculated your gain/loss for tax reporting purposes.

This is an extreme example, but with 18,000 corporate actions a year investors have no way of predicting when one will impact their portfolio. In fact, busy investors shouldn't even have to worry about corporate actions, wash sales, or characterizing gains and losses. That's what we're here for.

GainsKeeper is an expert in issues like these... so investors don't have to be.