Stock Dividends and Stock Splits—Taxable or Not?

A corporate shareholder can benefit from nontaxable stock dividends if they are structured properly. Stock dividends are distributions of stock made to shareholders from a corporation’s surplus account using its own stock. Generally, stock dividends are tax-free. However, they can be taxable in certain circumstances. For example, stock dividends are taxable if the shareholder has the option of receiving those dividends in cash or stock.

Stock splits merely represent divisions of outstanding shares into a greater number of shares with a lower per-share value. Companies that want to make their shares more attractive and affordable may authorize a stock split to create more shares selling at a lower price. For example, a 2-for-1 stock split doubles the number of existing shares and halves the price. Let’s say you own 1,000 shares of a stock selling at $20 a share, for a total value of $20,000. If the company’s directors authorize a 2-for-1 split, you would own 2,000 shares priced at $10 a share (subject to market fluctuation), with the same total value of $20,000. Your holding period (which determines whether long-term or short-term capital gain rates will apply) in the shares does not change, nor does your total basis in the stock. However, your per-share basis will be reduced in the same percentage as the stock split. For instance, if your basis in the aforementioned shares was $6 per share ($6,000 invested) before the 2-for-1 split, your per-share basis after the split is $3 per share (still the same $6,000 invested).

**Taxable Stock Dividends.** A stock dividend is taxable if you are given the choice between cash or stock as a dividend. Stock dividends may be taxable in other rare cases, as well. If your stock dividend is taxable, the basis of the new stock is its fair market value on the date of distribution. The holding period (long-term or short-term) begins on that date as well. Your basis and holding period in the old stock does not change.

**Nontaxable Stock Dividends and Stock Splits.** Calling stock splits and certain stock dividends “nontaxable” may be a misnomer. Rather than a permanent exclusion of income, they actually result in a deferral of income. While cash dividends may be taxed currently, any gain resulting from a stock dividend or stock split is realized when the shares are eventually sold. The holding period (long-term or short-term) for the new stock is the same as for the old stock.