

TA Cost Basis Issues

- Legislation passed by Congress as part of the Emergency Economic Stabilization Act of 2008
- Requires government filers (GF) to include in 1099B the cost basis of shares sold and long/short term gain/loss. Waiting for clarification from IRS – all TA's?
- Effective January 1, 2011 for equities and January 1, 2012 for DRP; must be able to exclude cost basis (CB) on sales of reinvested shares from CB on sales of underlying shares during 2011 on 1099B.
- Requires that TA's record cost basis on most transactions.
- Requires that TA's have the ability to pass cost basis to other government filers such as other TA's or brokers and must do so within 15 days of the share movement.
- TA's will be required to track open shares for which receipt of CB info from sending GF is pending and to reconcile and post CB info when received; or if the TA is the sending GF, track open shares where CB hasn't been sent to ensure compliance with 15 day rule. Must also have ability to reject CB records from sender.
- Requires that TA's have the ability to track and calculate CB by FIFO or identified cost (ie, specific share lots – high cost (HC), low cost (LC), LIFO) for underlying shares and average cost (AC) for DRP shares
- TA's must be able to record the original transaction date (vs posting date) in order to track long term vs short term gains/losses and adjusted holding period date for wash sales.
- TA's must have the ability to carry forward the original cost on share lots where only partial lots are being transferred and a new certificate is being issued for the balance of shares remaining.
- TA's must have the ability to carry forward the original cost on a share lot where the original certificate was lost and is being replaced.
- TA's must have the ability to take in and track multiple share lots for 1 certificate or book position.
- For stock dividends and splits and other corporate actions, TA's must record the new shares as a separate position with the same number of tax lots as the underlying lots that earned the new shares. The cost for the new shares will be derived by adjusting the cost basis of each underlying share position. TA's must still retain ability to run accurate record date positions. How should return of capital be recorded?
- TA's must have the ability to identify wash sale situations and adjust cost basis and holding period on the purchased or acquired shares for the disallowed loss. Original acquisition date must be retained for RD purposes.
- Additional fields that may be required in the tax lot include CB (and/or cost per share), acquisition/effective date, indicator if transaction is covered or uncovered (ie, reportable or not reportable), unknown (as with restricted stock plans) or pending, reason code if not covered, source of CB info. Also cost basis methodology (FIFO, LIFO, HC, LC, AC), processing date, CBRS unique identifier (receive), CBRS unique identifier (delivery), adjusted cost basis reason code, date of last cost basis adjustment, wash sale adjusted holding period date. May also need correction indicator and reason for correction.

- CBRS unique identifier will show the broker from which the CB was received while the tax lot is open. When the tax lot is cancelled and if the shares are moved to the street or presented by a broker and moved to another registered account, a 2nd CBRS ID would be created to reflect the passing of CB to the broker.
- TA's will need to track, reconcile and pass transactions that occur during conversion periods.
- Must be able to track pre (uncovered) and post (covered) effective date share lots.
- Do not need to apply AC to all accounts with same TAXID.
- Appears we won't need to maintain double category (LT vs ST) AC.
- If SH doesn't indicate which shares they want to sell, we can default to FIFO, unless AC has already been selected. If SH presents a cert for deposit and partial sale and the cert represents multiple lots and the SH doesn't indicate which lots to sell, we should default to FIFO within the tax lots represented by the cert.
- In order for AC to be used in DRP, all outstanding certificates must be surrendered and cancelled. If a SH requests a certificate (even for a partial position), they can stay in DRP but cannot sell until all certs are cancelled. If the cert is presented to a broker, we should pass AC, not the actual tax lot basis.
- Unclear whether ESPPs or DPPs will be treated like DRPs. STA recommended they should.
- Appears that IRS allows a SH who had previously elected AC (or who used the Plan's default AC) to change their election. The SH must file for an exception to the rule and are issued some kind of document from the IRS. The TA should request a copy of this document before we allow the change from AC to something else. What if the SH request this change prior to filing a tax return but after the sale?
- SH must indicate the CB methodology to be used for the specific sale transaction prior to the sale. No changes should be allowed, unless the IRS reg permits a change after the fact. If no preference is indicated, the default is FIFO. Still needs clarification from IRS.
- The CB methodology should be posted to the tax lot sold.
- Appears that cost basis methodology as well as tax lots sold may have to be reflected on the sale confirm.
- Certificates represent the specific tax lots for which the cert was issued. If a cert is presented for sale (or transfer), the lots represented by the cert must be debited. If a partial transfer or sale is requested, then the 10/1/2009 lots should be debited using FIFO.
- TA's will need the ability to accept and/or pass adjusted/corrected CB after the transaction and original CB were previously received/delivered.
- Cost basis field should accept zero as a valid amount.
- Need to provide shareholder with the CB when a cert is issued at request of broker. Do we need to provide regardless of who's requesting?
- Need to keep audit trail of requests to sender for CB in case of IRS inquiry.