



Wolters Kluwer  
Financial Services

## Analyzing the IRS cost basis reporting regulations:

*Critical updates for brokers  
& custodians on the  
new proposed regs*

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# Overview

- Proposed Regs issued Dec. 16<sup>th</sup>
- Only cover stocks, mutual fund & DRIP (DRP) shares (debt & options Regs will be issued later)
- Comments due Feb. 8<sup>th</sup> (hearing Feb. 17<sup>th</sup>)
- Regs cannot be relied on—only proposed
- Final Regs May or June at earliest
- No delay of effective dates

## Additional Info

- Proposed Regs are 141 pages
- IRS also released a draft Form 1099-B for 2011
- GainsKeeper has published a whitepaper on the proposed regulations, available upon request via the Contact Us link on [www.costbasisreporting.com](http://www.costbasisreporting.com)
- Copy of proposed Regs and draft Form 1099-B are in the law library section of [www.costbasisreporting.com](http://www.costbasisreporting.com)

# Webinar Agenda

- GainsKeeper's Top Ten Highlights of the Proposed Regs
- Review of the draft Form 1099-B & reporting rules (incl. reporting to S corps)
- Select issues with lot relief & consistency
- Averaging & dividend reinvestment plans
- Wash sales & corporate actions
- Transfer reporting including gift & death
- Corporate action reporting

# Scope of Webinar Coverage

- Focus on the big issues
- Broker & transfer agent perspective
- Allotted time insufficient for deep dive into details—attendees will receive a copy of this presentation and link to request a related whitepaper
- There are some glitches in the details of the Regs—we don't have time to cover those but will include the ones we spot in our comment letter

# CBR Prop Regs Top Ten Highlights - p. 1

1. Multiple lot relief methods must be supported; broker must follow customer's election (stock & averaging); and customers must report gain or loss using the method they elect (or the applicable default method);
2. No wash sales *de minimis* exception for dividend reinvestment plan ("DRP") wash sales or active trader (mark-to-market, Sec. 475) wash sales;

## CBR Prop Regs Top Ten Highlights - p. 2

3. A DRP is broadly defined to include issuer and broker plans as well as plans that involve only partial (10% or more) dividend reinvestment—thus any stock can be a DRP that determines the applicable effective date for covered security status;
4. Brokers must file corrected 1099's if transfer statement or corporate action details are updated or delivered late (no cutoff or *de minimis* rule) and transfer statements must also be corrected;

## CBR Prop Regs Top Ten Highlights - p. 3

5. Custodians, issuers and other securities industry intermediaries that are not considered brokers are obligated to provide (and receive) cost basis transfer statement reporting;
6. Transfer reporting format is not mandated, so brokers and persons subject to transfer reporting must be able to accommodate transfer reporting in a variety of formats;



## CBR Prop Regs Top Ten Highlights - p. 4

7. Customers will be able to elect out of (or elect into) basis averaging for mutual fund and DRP shares on a go-forward basis at any time;
8. Every transfer of securities between accounts of one taxpayer and another is subject to transfer reporting and is presumed to be a gift in the absence of additional information;

## CBR Prop Regs Top Ten Highlights - p. 5

9. Transfers of securities due to death or gift are subject to transfer and basis reporting and brokers must take additional steps in reporting such transfers; and,
10. Brokers can optionally report cost basis for pre-effective date (noncovered) securities and report basis adjustments in addition to those required for post-effective date (covered) securities without penalty.

## Review of the draft Form 1099-B & reporting rules (incl. reporting to S corps)

- Optional 1099 reporting of noncovered share basis & long-term/short-term
- Optional 1099 reporting of additional basis adjustments
  - Pre-effective date wash sales and option related
  - Employee plan related
- WHFITs carved out
- S Corp reporting requires recertification
- Foreign currency conversion/integration rule

# Draft Form 1099-B

7979

VOID  CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.		1a Date of sale or exchange	OMB No. 1545-0715		<b>Proceeds From Broker and Barter Exchange Transactions</b>
		1b CUSIP no.	<b>2011</b>		
		Form <b>1099-B</b>			
		2 Stocks, bonds, etc.	Reported to IRS <input type="checkbox"/>	<input type="checkbox"/> Gross proceeds	
		\$		<input type="checkbox"/> Gross proceeds less commissions and option premiums	
PAYER'S federal identification number	RECIPIENT'S identification number	3 Cost or other basis	4 Federal income tax withheld	<b>Copy A</b> For Internal Revenue Service Center File with Form 1096.  For Privacy Act and Paperwork Reduction Act Notice, see the 2011 General Instructions for Certain Information Returns.	
		\$	\$		
RECIPIENT'S name	5 Wash sale loss disallowed	6 Check if a non-covered security <input type="checkbox"/>			
Street address (including apt. no.)	7 Reported gain or loss	8 Type of gain or loss Short-term <input type="checkbox"/> Long-term <input type="checkbox"/>			
City, state, and ZIP code	9 Profit or (loss) realized in 2011 on closed contracts	10 Unrealized profit or (loss) on open contracts—12/31/2010			
	\$	\$			
	11 Unrealized profit or (loss) on open contracts—12/31/2011	12 Aggregate profit or (loss) on contracts	13 Bartering		
	\$	\$	\$		
Account number (see instructions)	2nd TIN not <input type="checkbox"/>	14 Description	15 Check if loss not allowed based on amount in box 2 <input type="checkbox"/>		

Form **1099-B**

Cat. No. 14411V

Department of the Treasury - Internal Revenue Service

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# Draft Form 1099-B - Key Changes

- Box 3 cost basis
- Box 5 wash sales
- Box 6 covered or noncovered security
- Box 7 reported gain or loss
- Box 8 long-term or short-term
- Up to 3 1099's for a single sale (it could be 4 if broker optionally reports basis on noncovered securities)

7979		<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0715		2011		Form 1099-B		Proceeds From Broker and Barter Exchange Transactions	
PAYER'S name, street address, city, state, ZIP code, and telephone no.				1a Date of sale or exchange		1b CUBIP no.		2 Stocks, bonds, etc. Reported to IRS <input type="checkbox"/> Gross proceeds <input type="checkbox"/> Gross proceeds less commissions and option premiums			
PAYER'S federal identification number		RECIPIENT'S identification number		3 Cost or other basis		4 Federal income tax withheld		5 Wash sale loss disallowed		<b>Copy A</b> For Internal Revenue Service Center File with Form 1099. For Privacy Act and Paperwork Reduction Act Notice, see the 2011 General Instructions for Certain Information Returns.	
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Street address (including apt. no.)				7 Reported gain or loss		8 Type of gain or loss Short-term <input type="checkbox"/> Long-term <input type="checkbox"/>		9 Profit or (loss) realized in 2011 on closed contracts			
City, state, and ZIP code				\$		\$		10 Unrealized profit or (loss) on open contracts—12/31/2010			
Account number (see instructions)				2nd TIN not. <input type="checkbox"/>		11 Unrealized profit or (loss) on open contracts—12/31/2011		\$		12 Aggregate profit or (loss) on contracts	
						13 Bartering		\$		14 Description	
										15 Check if loss not allowed based on amount in box 2 <input type="checkbox"/>	

Form 1099-B Cat. No. 14411V Department of the Treasury - Internal Revenue Service  
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# Select Issues with Lot Relief & Consistency

- Lot relief method selected no later than settlement date
- Standing orders permitted
- Customer/advisor surprise at consistency requirement
- What is a lot? Limit orders and level of detail—concerns regarding customer reconciliation with partial fills

# Averaging & Dividend Reinvestment Plans

- Application to closed end funds & ETFs
- Severe limitations on availability of single account election
- Lot relief selection within an account between covered average pool and noncovered pool
- Are different classes of shares of a single fund covered under a single election/pool?

# Wash Sales, Adjustments & Corporate Actions

- Pre-effective date wash sale basis adjustments to covered shares can be optionally included by broker
- Brokers must adjust for return-of-capital (ROC)—preamble acknowledges that adjustments likely after end of year
- Brokers must report and make corporate action adjustments for foreign stock



# Transfer Reporting

- Transfer statement for all transfers including noncovered securities and transfers to exempt recipients
- Requesting complete transfer statement if not received
- Transfer reporting can apply to issuers, transfer agents, professional custodians and others that may not effect sales
- For direct registration & certificates shares—issuer or its transfer agent is subject to transfer reporting

# Transfer Information Required

- Must identify applicable person providing statement; broker receiving statement; owner transferring securities; owners post-death & gift transfer; the securities being transferred; date transfer initiated and settlement date of transfer
- Transfer statement must include: total adjusted basis; original date of acquisition; date for determining gain or loss long-term/short-term; indicate extent to which basis adjusted for corporate actions by reporting the number from the issuer statement of the most recent corporate action reflected on transfer statement; for average basis stock original acquisition date can be reported as "VARIOUS" for stock owned at least 5 years; plus FMV as of date of gift

# Transfer Statement Tidbits

- Original purchase amount, reason why noncovered and basis method used prior to transfer not required BUT additional information may be communicated with statement even if not required
- If a transferor receives an updated transfer statement that securities transferor transferred were covered securities, transferor must send a corrected statement within 15 days
- Transfer agents don't have to make basis adjustments for corporate actions or compute average basis—burden on receiving broker to make these prior adjustments

# Death & Gift—Treated as Transfer Reporting

- Gifts and inheritance of covered securities must be reported on transfers
- Inheritance—transfer stmt must indicate so and date of death as acquisition date and value based on authorized rep of estate
- Gift—so indicate, state adjusted basis in hands of donor and original acquisition date; date of gift and FMV of gift on date
- Valuation rules for gift & death for privately traded securities

# Corporate Action Reporting

- Corporate action ID number: a unique number assigned by the issuer for each corporate action reported (used in transfer reporting to identify last action processed)
- Post on public company website in lieu of filing with IRS and holders
- Key tax info: quantitative effect on basis of corporate action (as an adjustment per share or as % of old basis), including a description of calculation, applicable Code Sec. and subsection upon which the tax treatment is based, data supporting calculation such as market values and valuation dates and any other information necessary to implement the adjustment including reportable tax year and whether any resulting loss can be recognized

# Effective Dates & Next Steps

- Generally effective when final
- Reporting basis and It/st effective based on law effective dates (1/1/11; 12; 13)
- Effective dates for short sales seems glitched (1/1/10)
- Comments will be submitted and reviewed
- Final regs? New proposed regs? Temp. regs?
- When? Compressed implementation timeline

## Final Observations

- Significant complexities will challenge brokers and technology systems:
  - LOT RELIEF; AVERAGING; WASH SALES; TRANSFERS
  - RETURN OF CAPITAL & CORPORATE ACTIONS
  - FOREIGN SECURITIES; INHERITANCE & GIFT
- Rules will morph and new challenges loom due to pending coverage of debt instruments and options acquired on or after Jan. 1, 2013
- Customers will likely be confused and brokers and advisors will need additional resources to manage customer questions and frustration



# Considerations

- GainsKeeper does not provide tax advice. You should consult your own tax advisers and they (and not GainsKeeper) are solely responsible for any tax, tax penalties or interest related to their tax returns
- GainsKeeper is a tool to assist taxpayers but does not cover a variety of specific tax rules or taxpayer circumstances and facts