



COST BASIS REPORTING RULES SET TO GO INTO EFFECT 1/1/2011. IS YOUR COMPANY READY?

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Background on the New Law

In what will surely be a sea change to the brokerage and custodian information reporting community, the 2008 Energy Improvement and Extension Act added new § 6045(g) to the Code that will require basis reporting for sold securities. Thus, if a broker is otherwise required to report gross proceeds from a "covered security" on form 1099-B, he must include in the return (1) the customer's adjusted basis in the security; and (2) whether any gain or loss is long-term or short-term.

A "covered security" is a specified security that was acquired through a transaction in the account on or after the applicable date, or was transferred to the account from an account where it was a covered security, but only if the broker received the required transfer statement from the transferor.

A "specified security" includes stocks, mutual funds, debt instruments, options, commodities, derivatives, and any other financial instrument that the IRS determines that adjusted basis reporting is appropriate. IRC § 6045(g)(3)(B))

The "applicable date" depends on the type of specified security that is sold. For stock, the applicable date is Jan. 1, 2011. For shares in a mutual fund or stock acquired in connection with a dividend reinvestment plan (DRIP), the applicable date is Jan. 1, 2012. For any other specified security, the applicable date is Jan. 1, 2013, or a later date determined by the Secretary.

Transfer Statements

A broker who transfers securities to another broker must provide the receiving broker a written statement within 15 days of the transfer containing the information necessary to comply with the basis reporting law.

Issuer Statements

Under Code Section 6045B, an issuer of a security that has an organizational action, such as a stock split, merger, or acquisition, that affects the basis of the security must file an information return with the IRS no later than the earlier of 45 days after the action,

or Jan. 15 of the year following the calendar year when the action occurred. The issuer must also provide a statement to the security holder no later than Jan. 15 of the year following the calendar year when the action occurred. Issuers may satisfy either requirement by making the information publicly available on their website (Proposed Regs).

Reporting Basis

A broker determines and reports a customer's adjusted basis under the following statutory rules: For corporate stock, if the taxpayer owns more than one lot of stock, the broker determines basis using the FIFO method, unless the customer notifies the broker otherwise; for mutual fund shares or DRP stock, the broker uses its default method unless the customer notifies the broker that he elects another acceptable method.

Wash Sales

In determining basis, brokers must take into account the wash sale rule, but only if the transactions occur in the same account with respect to identical securities.

Short Sales

Beginning with the 2011 tax year, brokers report proceeds and basis in the year that the short sale is closed rather than the current rule for reporting the proceeds in the year the short sale is entered into.

Proposed Regulations

On Dec. 16, 2009, the IRS issued proposed regulations on the broker basis reporting rules. The proposed regulations provide rules for determining basis, for reporting adjusted basis, and for reporting whether any gain or loss on a sale is long-term or short-term. The proposed regulations also address the new reporting requirements imposed upon persons transferring custody of securities and upon issuers of stock. The proposed regulations are anticipated to be finalized in the spring of 2010.

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