

Tonight we're going to talk about Cost Basis Reporting. What it is and why it's important that we talk about it.

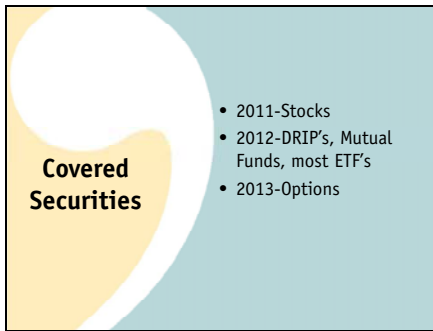
Just one disclaimer. The new reporting rules are a bit complex. Tonight we will be discussing those that most frequently will apply to investment clubs. If you have any questions about how any of this information applies to your club,

please contact us at [support@bivio.com](mailto:support@bivio.com) to discuss the situation further.

Just to start with a little bit of history, Congress passed the Emergency Economic Stabilization Act on

October 3, 2008

You may fondly remember this as the TARP or bailout bill. To make you love it even more, it turns out it contained a provision which added the requirement that, when you sell an investment, your broker has to start reporting something called your adjusted cost basis and whether your gains or losses are short or long term. Prior to this, they were only required to report the gross proceeds of any sales. There was no documentation sent directly to the IRS to confirm how much taxable gain or loss you had had.



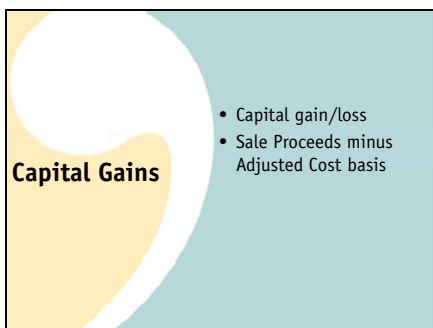
The change requires a lot of work on your brokers part, and will probably create confusion amongst investors, so the IRS has agreed to phase in compliance with the requirements over three years.

The new rules have already begun for stocks and other equities that you purchased starting this year.

For 2012, it will also start to apply to DRIP's, ETF's and Mutual fund shares. Note that DRIPS refer to qualified dividend reinvestment programs, not the situation where you have asked your broker to automatically reinvest dividends for you.

Finally, in 2013, the new rule will be applied to fixed income, futures and options purchases.

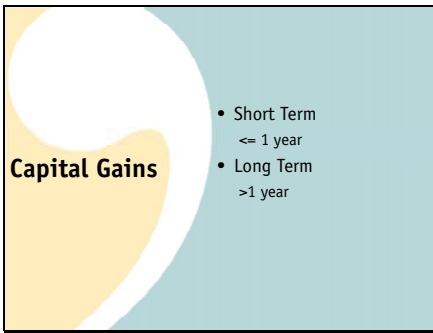
The IRS is using the term "Covered Securities" to describe which of your holdings the new reporting rules apply to. You should familiarize yourself with the term because you will see it on the various new tax forms you will be receiving and preparing. Brokers are only required to report information on covered securities. Purchases made before the effective dates are called non covered securities. Brokers have an option whether they want to report information on non covered securities also. So, for example, if you sell stock which you acquired in both 2009 and 2011, they are only obligated to report to the IRS on the stock you purchased in 2011. It is, however, still your responsibility to correctly report any gains or losses associated with the stock purchased in 2009.



Let's first step back for a moment and talk a little bit about your investments and tax reporting. When you own an investment, of course you know, there are tax implications related to the gain or loss when you sell it.

We call these capital gains and losses.

They are calculated by subtracting something called your Adjusted cost basis from the net proceeds of your sale.



For tax purposes, gains and losses are classified as either

Short term or

Long term, depending on how long you held the investment before you sold it. Long term means you held the investment longer than a year. Short term means you held it for less time than that. Long term gains are currently taxed at a special, lower rate than short term gains.



To determine your capital gains you need to know your cost basis. It will be different for each purchase of an investment. The original cost basis is the total of:

The original price you paid

And any commissions and fees.

Once you own a stock, its basis can continue to be adjusted due to the tax impact of things like

wash sales

And Corporate actions such as

Stock Splits

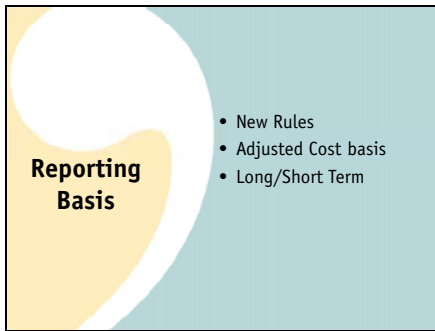
Mergers

Spinoffs and

Stock Dividends.

In addition, if part of any distribution you receive from an investment is a return of capital, that will affect the cost basis of all the shares you own.

Your basis at the time of a sale, after taking all these things into account is called your Adjusted Cost basis.

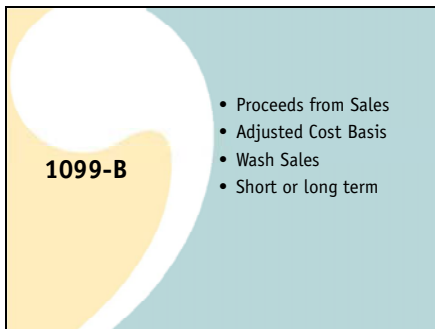


Prior to the new rules taking effect, the only thing your broker had to report was the gross proceeds from any sales you had.

Under the new rules, they will also have to

track and report your adjusted cost basis and

Report whether you held the investment long term or short term. This is all the information the IRS needs to determine the gain or loss you should be reporting on your taxes.



The new information will be reported to you on an IRS form called a 1099-B. It will be expanded from what you have received before and will include additional fields for information such as:

Proceeds from sales (currently reported)

Adjusted cost basis

Any non deductible loss due to wash sales

Whether a gain or loss is short- or long-term

When the sale of covered securities includes gain or loss that is short-term and long-term, brokers must report the securities held for a short-term period and the securities held for a long-term period separately.

They also still have to report separately under the old rules for noncovered securities. This means that a single sale in an account could require as many as three separate returns if the sale included covered securities held less than one year, covered securities held longer than one year, and noncovered securities.

**Where will Your Broker Get the Data?**

- Transactions in your account
- "Transfer" statements
- "Issuer Reports"

Where will your broker get the data to calculate your cost basis so they can report to you?

First of course, they will have the information about transactions that have occurred in your account.

In the future, if you transfer in investments from another broker, that broker will need to provide the new broker with a "transfer statement" that will list the relevant history needed by the new broker.

If a company goes through a reorganization, they will be required to provide the details of the impact on stock cost basis to the brokers so they can make the appropriate adjustments. This information will also be posted on their websites. You may need to request this information from your broker so that your accounting in bivio can be adjusted in the same manner as your broker is adjusting it.

**Where will Your Broker Get the Data?**

You

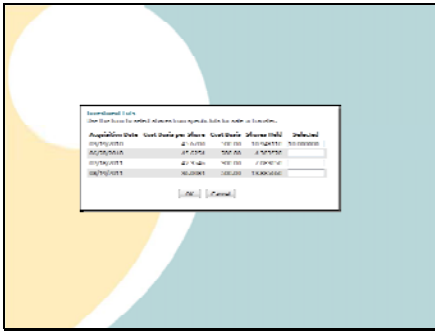
<click>You can also fill in missing historical information at your brokerage website. As I mentioned earlier, while your brokers are not required to report cost basis data for other than "covered transactions", some of them will do this.

If you have not filled in missing information, your broker will need to make some assumptions when a sale occurs. He will first assume that the sale affects any shares or units in the account for which he does not know the purchase date and that the basis of any securities without data is zero. He will then select the shares beginning with the earliest date that he knows whether they are covered or non covered securities.

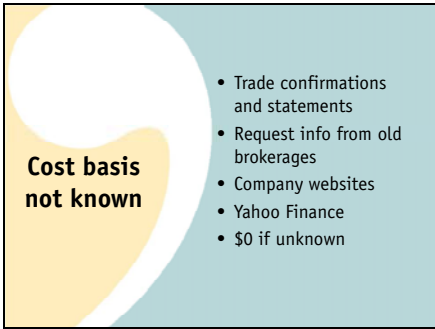
So where can you find cost basis information if your broker doesn't have it?

Lucky you. It is something that has been being tracked and adjusted in your bivio records. If you open the sale entry form,

You'll see a little button labeled lots



Clicking on it will bring you to this screen which will show you all the lots you own and their cost basis.



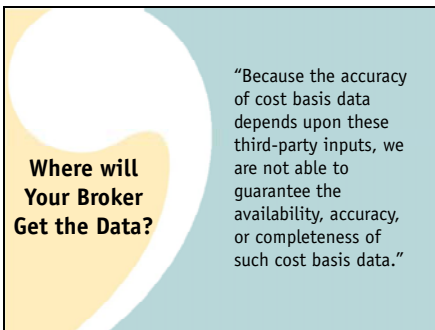
If, for some reason, you don't have the data available in your club records,

you should try to locate your original statements and trade confirmations or request copies from your other brokers to obtain cost basis for your securities.

You can also frequently find historical pricing information in the investor relations sections of company websites or

On Yahoo Finance.

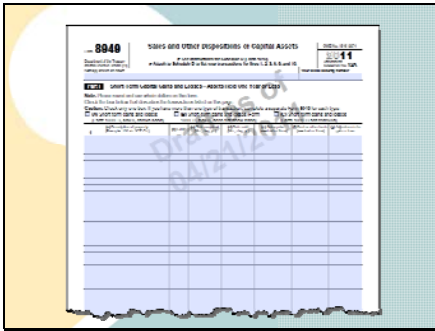
The IRS indicates you should report \$0 as the cost basis if can't prove the actual basis or make an estimate that can be substantiated. So whenever using an estimate, we strongly encourage you to consult with a qualified tax advisor, CPA, financial planner, or investment manager.



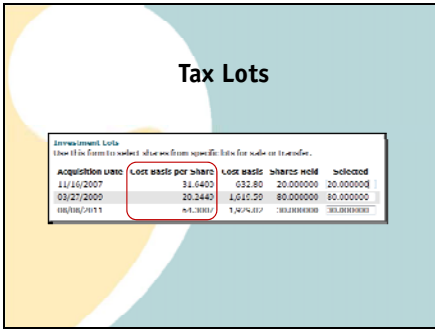
It is a good idea to compare your brokerage information with what you have in vivo and to make sure any differences get resolved. Don't assume your brokerage has the right information. Brokers have the obligation to report the information "To the best of their ability" However, you will probably find some sort of disclaimer on their sites like this:

"Because the accuracy of cost basis data depends upon these third-party inputs, we are not able to guarantee the availability, accuracy, or completeness of such cost basis data."

It is still your responsibility to make sure that the correct facts are reported to the IRS.

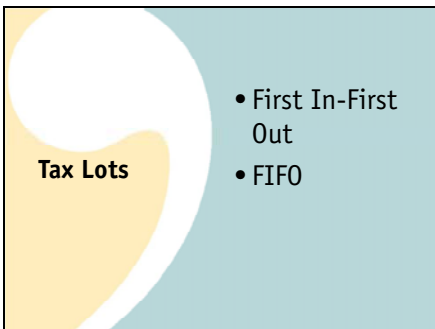


Along with the new version of the 1099B you'll actually have to report information differently depending on when you first purchased an investment. For your personal tax forms, there will be a new form, Form 8949 which will go along with your schedule D. There is currently no mention of a similar form for your partnership tax schedule D though it certainly seems like there's a good chance one might be coming.



If you have purchased a stock at several different times, including purchases you made when you reinvested dividends, you will have what are called different tax lots.

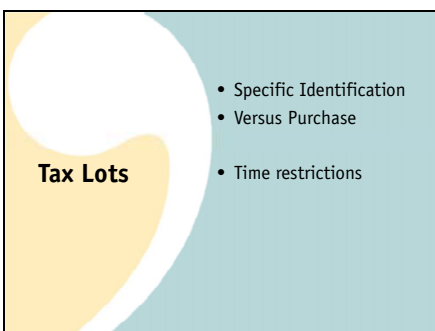
There will be a different cost basis associated with each of them. If you do not sell all of them at one time, your taxable gain or loss will depend on the cost basis of the lots you actually sold. This will need to be identified by the broker in order to prepare your reports correctly.



For stocks, by default and per the IRS requirements, the oldest lots will be sold first.

This is called First In First Out

Or FIFO

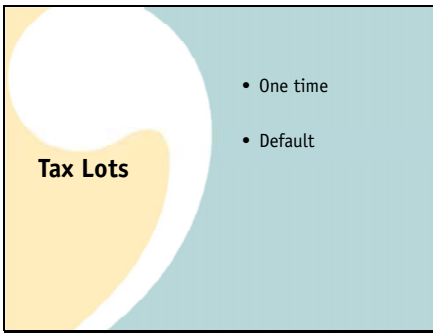


But you do have options. if you want to, you can identify specific lots which you want to sell. This is called

Specific Identification or some brokers refer to it as

Versus Purchase.

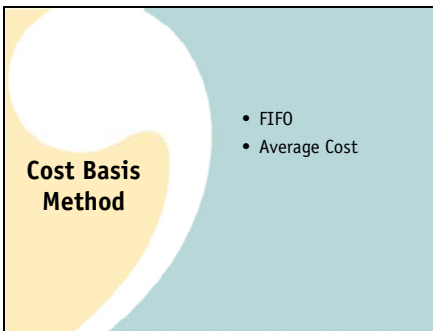
The most important thing to know about this is that it needs to be done before a trade settles. It cannot be changed later.



Because of the new rules you will have two options for identifying which tax lots you will be selling.

You can identify lots at the time of an individual trade

Or, there will be a default method of selection that will be used for any trades that happen in your account.

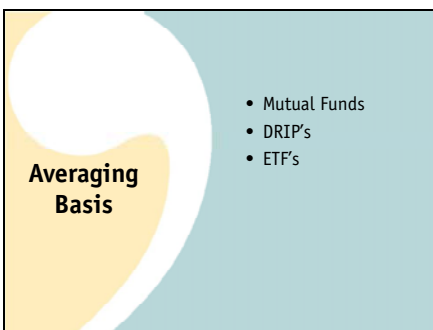


Brokerages are calling this selection of a default, your “Cost Basis Method”

If you do not change it, they should set the default to comply with IRS guidelines.

The IRS specified default for stocks is FIFO

For mutual funds, ETF’s and DRIP’s the brokerages are going to be allowed to choose Average Cost as their default cost basis method. From a review of some of the most popular club brokerage websites, it appears this is what is being most commonly offered.



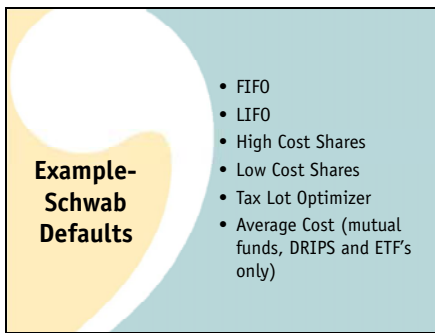
You have been able to use average basis for mutual funds in the past. However it was extremely difficult to change that election once you had chosen it.

The new reporting requirements also allow you to use Average basis for

DRIP’s and for

most ETF’s starting in 2012. You did not have that option in the past and it will not be retrospectively applied to shares you already own. Note that DRIP averaging does not apply if you are having your broker automatically reinvest dividends. It only applies to qualified DRIP plans.





Brokers may provide you with choices of default cost basis methods. For example, here's the list I found at Charles Schwab. They are offering:

**FIFO (First In First Out)** Shares you acquired first are sold first. This is Schwab's default method for all securities except mutual funds.

**LIFO (Last In First Out)** Shares you acquired last are sold first.

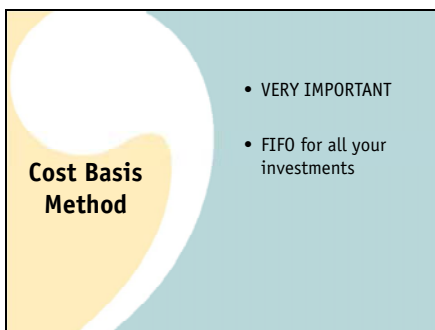
**High Cost Shares** with the highest cost are sold first.

**Low Cost Shares** with lowest cost are sold first.

**Tax Lot Optimizer**- Many brokers are offering choices with compelling names such as this. Make sure you understand that this name can be misleading. What is "optimal" for your personal tax situation may not be "optimal" for someone else's. If you select this choice, make sure you really understand the impact it will have on the gains and losses you will have to report. In Schwab's case, they have a long description of how selections will be made if you choose this.

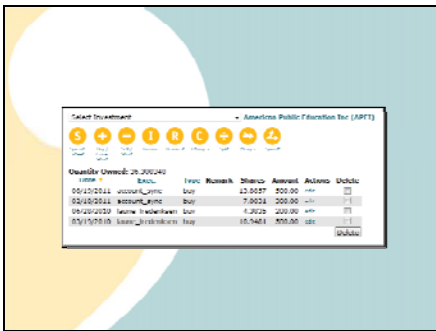
**Average Cost** – This choice is only offered for Mutual Funds, DRIP's and ETF's

It is computed by dividing the total dollar amount invested in a particular position by the number of shares held prior to the trade date.

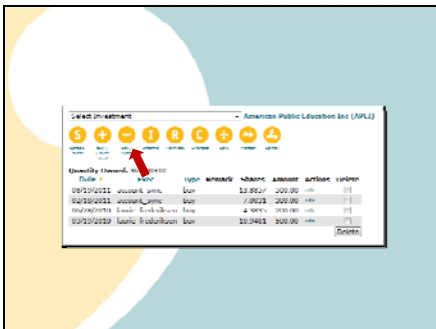


You should make sure that you go to your brokerage site ASAP and confirm what they have set as a default for a cost basis method for your account. This is important because you will need to make sure your transactions in bivio are recorded using the same set of rules.

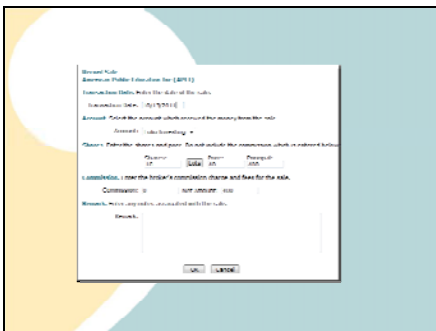
To keep your club accounting as simple as possible, we highly recommend that you select FIFO as the cost basis method for all your club trades. At this point, any other method will require you to make manual adjustments to your club records.



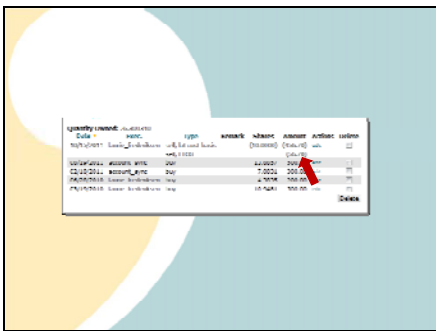
Here's an example of what you would need to do. Suppose you had a stock that you had purchased on multiple occasions, and you want to sell only some of it.



You'd use this button on the Accounting>Investments page



To open the sale form in bivio and enter the details of the sale. If you use AccountSync, this would have all been entered automatically for you.



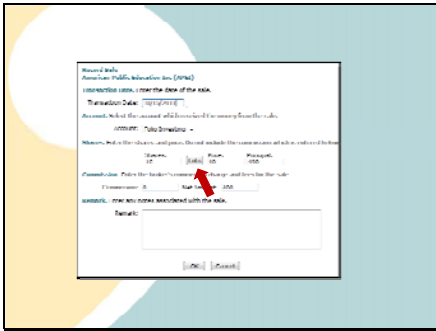
After you confirmed it, bivio would enter the sale and calculate your

gain or loss based on FIFO and record a sale of the oldest shares you owned first.



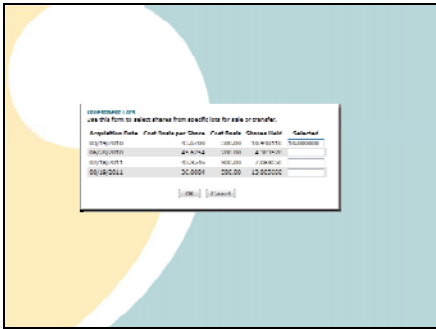
If you had used some cost basis method other than first in first out, you'd need to either adjust the way you made the original entry or

edit the entry that was made, perhaps by AccountSync.

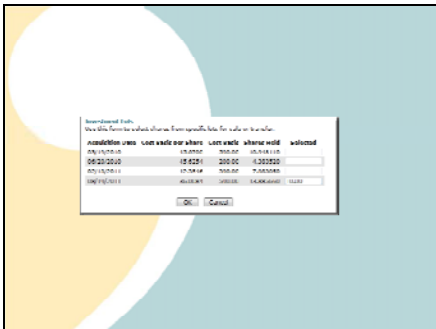


Using the edit link, you can reopen the sale entry form.

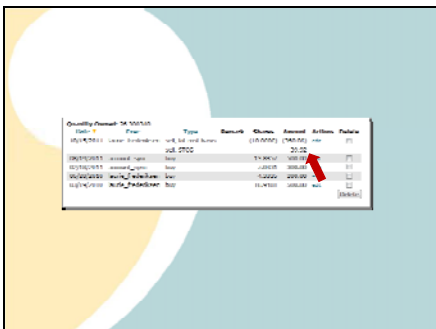
On it, you'll see this little button labeled "Lots"



Clicking on it will bring you to this screen which will show you all the lots you own and which lot the sold shares were taken from. By default, the oldest shares will have been picked.



If you've told your broker to sell a different lot, just change the information on this screen.



After you accept the entry, you will see

that a different gain or loss has been recorded.

When the oldest shares were sold first, this club had a \$56.70 Long Term Capital Loss

When the club specified to sell some of the most recently acquired shares, they have a \$39.95 short Term capital gain to report.

**When must taxpayer select lot**

- **BEFORE** Trade Settles
- Pick FIFO as your default setting

Don't forget,

Specified lot decisions must be made and communicated to your broker before the trade settles. This is typically within three days for equities and one day for mutual funds. Once the trade settles, the method used will be final and cannot be changed.

If you set up FIFO as your default setting for all your trades, you will not have to make any manual edits in bivio. If you do not, they will be recorded at your broker using your brokerage default settings and you will have to make adjustments in bivio produce correct tax forms.



We're letting you know this in advance because we want to make sure you stay a one minute treasurer and your club record keeping stays as simple as possible!

**Wash Sales**

- What is it?
- Loss changes basis
- Holding period adjusted
- Substantially Similar

Another new reporting rule concerns wash sales.

A wash sale occurs if you sell securities at a loss and buy substantially similar replacement shares within 30 days before or after the sale. In general, the tax deduction on a wash sale loss is deferred.

The loss is added to the basis of the shares you still own and

The holding period is adjusted to include the holding period of the shares that were sold.

For purposes of the wash sale rule, securities are considered "substantially similar" if they are issued by the same company. Stocks, dividends, and even options for stocks may trigger a wash sale. In fact, the purchase and sale do not even have to occur in the same account.

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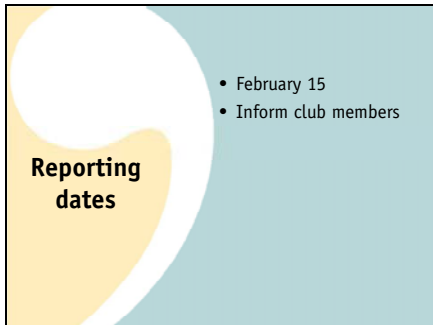
**Wash Sales**

- Not all will be reported
- Increased compliance

While you have had to do this for some time, brokers have never reported it to the IRS. That is now changed too, if both the purchase and the sale occur within your brokerage account.

You must still comply with the wash sale rules whether the transactions occur in the same or different accounts. So, you will have more of a chance that a wash sale will be reported to the IRS and they will expect correct basis adjustments.

Wash sales are not entered automatically in bivio. Make sure to contact us to adjust your records correctly if you have one.

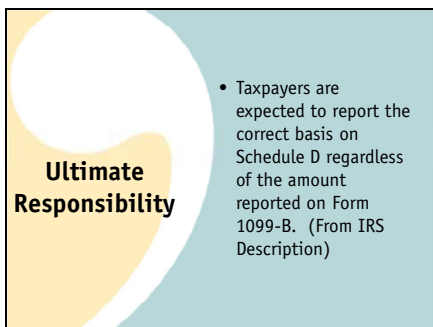
A graphic with a teal background and a yellow and white abstract shape on the left. The text 'Reporting dates' is in bold black font. To the right, there is a bulleted list.

**Reporting dates**

- February 15
- Inform club members

Time for Furnishing Statements – Because of the new reporting rules the IRS has permanently extended the due date for brokers to report securities sales to customers on Form 1099-B to February 15.

This means you should let your club members know that they will probably not be receiving their club K-1's until sometime after that.

A graphic with a teal background and a yellow and white abstract shape on the left. The text 'Ultimate Responsibility' is in bold black font. To the right, there is a bulleted list.

**Ultimate Responsibility**

- Taxpayers are expected to report the correct basis on Schedule D regardless of the amount reported on Form 1099-B. (From IRS Description)

Just to summarize. The new rules mean there will be more reporting to the IRS by your broker but the ultimate responsibility for reporting gains and losses correctly is yours.

The IRS requires Brokers to make a “reasonable” attempt to report correct amounts. However, this is a complex topic and there are sometimes limitations in the information the broker is using to make cost basis determinations.

If your records disagree with the brokers, make sure you understand why or have us help you figure out why. You can't automatically assume what is on the 1099-B is completely correct. In the IRS's own words “ In many cases, basis reported on Form 1099-B may not reflect the taxpayer's correct basis. For example, brokers need not adjust basis for wash sales unless the transactions that trigger the wash sale occur in the same account with respect to identical securities. Additionally, brokers are permitted, but not required, to report basis for noncovered securities.

As the IRS says themselves “Taxpayers are expected to report the correct basis on Schedule D regardless of the amount reported on Form 1099-B.”

**Bottom Line**

- Keep things Simple
- FIFO
- Compare

The bottom line for your club is that we recommend you

Keep your club record keeping as simple as possible

Make sure the default cost basis method for all investments at your broker is FIFO ASAP

Spend some time now comparing the information your broker has for cost basis with your bivio records.

**References**

- Brokerage Website
- New Rules
  - [http://www.irs.gov/irb/2010-47\\_IRB/ar08.html#d0e723](http://www.irs.gov/irb/2010-47_IRB/ar08.html#d0e723)
- Issuer Guidance
  - [http://www.irs.gov/taxpros/article/0,,id=237099\\_00.html](http://www.irs.gov/taxpros/article/0,,id=237099_00.html)
- [support@bivio.com](mailto:support@bivio.com)

If you'd like to learn more about this, here are couple of good sources.

First, you might check out your brokerage website. Most brokers are gearing up for an onslaught of confusion about all this at tax time. I found that a lot of them have very comprehensive sections explaining things.

Of course, you can always go to the IRS themselves. This link will take you to the current version of the rules.

This link will take you to the description of how things are going to need to be done that they have posted for tax preparers and those who will be issuing the new reporting forms.

And, of course, you are always welcome to contact us with questions also.

[www.bivio.com/clubmm](http://www.bivio.com/clubmm)

**Coming Events**

- Trefis Presentation-November 17
- Challenge Club-November 8
- Dashboard Diagnostics-November 15
- December Club Meeting Meeting-Getting Ready for Tax Season-December 1

