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New Cost Basis Reporting – What It Means To You

The Emergency Economic Stabilization Act of 2008 included new tax reporting requirements that will dramatically change the way investors and financial advisors think about cost basis.

Custodians and broker-dealers will be required to report the adjusted cost basis of sold securities, including whether the gain or loss is short- or long-term, to the IRS on Form 1099-B. This shifts responsibility for reporting from taxpayers to custodian and brokerage firms (i.e. Charles Schwab & Co., Inc.).

Requirements, which will be phased in over three years, 2011-2013, apply to:

- Equities acquired on or after January 1, 2011
- Mutual funds, ETFs (exchange traded funds) and dividend reinvestment plans (DRIPs) acquired on or after January 1, 2012
- All other securities, including fixed income and options, acquired on or after January 1, 2013

Other requirements for custodians extend well beyond reporting cost basis. These include but are not limited to the following:

- System rules will need to be incorporated to comply with staggered effective date schedule
- Segregation of covered and uncovered shares/lots will be required

- Account holders will be allowed to specify a tax lot to sell at the time of trade
- Begin tracking and reporting on wash sales at the account level only
- Ensure that custodians/brokers can send and receive the cost basis for all types of security transfers
- Ensure that data from the cost basis system is compliant and reconciled with the existing 1099-B tax proceeds reporting system
- Form 1099-B will be redesigned to accommodate the newly required data for delivery in 2012
- Educate and communicate relevant impacts to clients

Frequently Asked Questions:

What is cost basis and why is it important?

Cost basis is the value of a security at the time it was purchased or acquired. When the security is sold, the gain or loss on the investment is the difference between the sale price and the cost basis, adjusted for commissions and other fees. Generally, you pay taxes on an investment gain or you use an investment loss to offset other taxable investment gains, so having an accurate record of the amount you originally paid - the cost basis - is important in calculating your tax liability.

What is changing?

Historically, custodian and brokerage firms were only responsible for reporting gross proceeds to the IRS when an investor sold securities. The investor was responsible for maintaining the cost basis of the security, calculating the gain or loss on the sale and reporting it to the IRS. In 2008, as part of the Emergency Economic Stabilization Act, Congress shifted responsibility for calculating the cost basis on the sale of an investment to the custodian and brokerage firms. Starting for tax year 2011 your custodian/brokerage firm will be providing you **and** the IRS with both gross sale proceeds and cost basis information on securities where they have the cost basis information. You will need to provide your tax preparer with all your 1099 reporting statements. Cornerstone Capital Advisors will no longer be generating separate "realized gain/loss" reports starting for tax year 2011.

Why did Congress pass this law?

Capital gains taxes have long been believed to be underpaid due to the incorrect reporting of cost basis by shareholders. Shareholders who hold investments for years may misplace records of the purchase. If shares of the security are inherited or received as a gift, the cost basis information can be lost. Congress believes the new legislation will result in more accurate reporting of investment gains and losses going forward for shares purchased after the effective date, and that it will simplify tax return preparation for taxpayers since their custodian or brokerage firm will do the cost basis tracking and calculations for them.

What cost basis methods are available?

You are allowed to elect your cost basis method with each custodian/brokerage firm. We have elected to use FIFO (first in first out) as the default method with your accounts at Charles Schwab. In certain situations, we will elect to utilize the specific lot identification method. Cornerstone Capital Advisors will inform Charles Schwab at the time of the trade if a different cost basis method is to be utilized.

What about mutual fund shares I acquired or will acquire before 2012?

Mutual fund shares acquired before 2012 are not covered by the new legislation. Mutual fund shares will be considered "covered" only if they are purchased on or after the effective date of January 1, 2012. Though custodian or brokerage firms are not required to report cost basis to the IRS on the sale of "non-covered" securities, we are reconciling our internal portfolio management system's data with Charles Schwab's data so that Charles Schwab can report the cost basis of non-covered securities to you. This is applicable to the extent that Cornerstone Capital Advisors has received your "historic" cost basis information.

How and when will I receive the cost basis information for my investments?

The first time the new cost basis information will be available to you and the IRS will be in early 2012 – reported on your 2011 Form 1099(s).

Does this change how I file my tax returns?

No, the new legislation does not change your obligation to accurately report capital gains and losses in your annual tax filings. You will need to provide your tax preparer with all your 1099 reporting statements. Cornerstone Capital Advisors will no longer be generating separate “realized gain/loss” reports starting with tax year 2011.

If you have any questions regarding these changes, please feel free to call your advisor.