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## IRS Seeks Input on Cost-Basis Reporting

By **CHRIS KENTOURIS**

The Internal Revenue Service has asked for industry input on implementing the cost-basis reporting requirements included in the economic bailout bill passed in October. Comments are due March 2.

While some broker-dealers, mutual funds and transfer agents offer cost-basis accounting as part of their customer service functions, under the Emergency Stabilization Act the disclosure burden will shift from investors to the firms. Customers' cost basis will need to be reported for stock purchases beginning in 2011, mutual funds and dividend reinvestment plans in 2012 and debt instruments, options and other securities in 2013.

The IRS on Feb. 6 requested comments on 36 topics spanning eight categories: the applicability of reporting requirements; basis method elections; dividend reinvestment plans; reconciliation with customer reporting; special rules and mechanical issues; transfer reporting; issuer reporting; and broker practices and procedures. The short comment period is necessary because "the IRS needs sufficient time to prepare guidance so that firms may make the necessary changes to their database and other software systems," said Stevie Conlon, tax director of Wolters Kluwer Financial Services' GainsKeeper unit.

Among the topics the IRS is looking to address is whether an issuer's classification

of an instrument as a stock or debt determines which effective data applies, and identifying the "middleman" who is subject to the cost-basis reporting and transfer reporting statement requirements. The agency also wants to know how to ensure that customers are informed of their broker's default methodology for cost-basis reporting and how brokers should be notified that a customer is opting for a different methodology.

When a broker's client buys a stock, the shares are assigned a lot number. If a customer holds multiple lots of the same security, the firm has to determine which group to sell in a transaction. Under the new law, the default for equities is the first-in-first-out methodology, while for dividend reinvestment shares and mutual funds the average cost basis is the default. In its request, the IRS asked under what circumstances a customer can change from the average cost basis to the first-in-first-out approach. Clients can also opt for a "specific ID" methodology that lets them first sell the lot of securities that optimizes their tax position.

"The IRS is attempting to determine how much flexibility a broker-dealer and mutual fund complex should give their customers in deciding which methodology to use," said Conlon. "The amount of flexibility will determine the level of IT changes which a firm must make." Firms have to keep track of additional data to make the

calculations and banks and brokerages often receive accounts transferred from other financial institutions, which may have inaccurate cost-basis data, or none at all.

In addition, the IRS is seeking to determine to what extent the average cost method applies to purchases or transfers made in dividend reinvestment plans. At issue is whether investors who choose to participate in the plans after they have purchased shares in a company will be subject to the 2011 or 2012 date when determining their cost-basis reporting obligations.

In the case of an account that has been moved from one financial intermediary to another, the IRS asked what information should be included in the transfer reporting statements and whether the current 15-day standard for the exchange of information is sufficient. The agency is also seeking input on whether electronic transfer reporting is appropriate and, if so, whether a common format should apply. Brokers and transferring parties, noted the IRS, might rely on a third party to meet their transfer reporting requirements.

Issuers will also face additional cost-basis reporting demands for corporate actions. The IRS asked what information about the issuer and "organizational action" should be required on the issuer tax returns sent to investors—and how to maximize delivery of that data.

