# Added cost basis responsibilities for the taxpayer

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*Cost basis is the amount of money originally put into an investment before any growth or loss. This includes the initial investment as well as fees and commissions paid to obtain the investment. Cost basis is primarily used to calculate the capital gain or loss on an investment for tax purposes. It is very important to know since the Internal Revenue Service (IRS) determines how much you should pay in taxes or deduct from your taxes based on the cost basis.* (eHow definition)

Cost Basis reporting requirements changed starting January 1, 2011 as part of HR 1424, the Emergency Economic Stabilization Act of 2008. The changes are designed to ensure greater reporting accuracy to reduce lost tax revenue as the IRS estimates approximately $11 billion in tax dollars are lost annually due to under reporting. Prior to these changes, the taxpayer has been responsible for reporting cost basis and gains and losses on applicable transactions. The new law requires brokers to report gross proceeds for securities sales to the IRS on Form 1099-B, which will then be required to be reported on individual income tax returns. *Note: Form 1099-B is not required for money market fund accounts, pension and profit-sharing plan accounts, IRAs, and accounts owned by non-resident aliens, certain tax-exempt organizations, and certain financial institutions, although Form 1099-Div (for dividends) or Form 1099-R (for distributions) may be required.*

The reporting requirement changes are broken into three staggered effective dates for different types of investments:

*Stock – January 1, 2011

*Mutual Fund & DRIP shares – January 1, 2012

*Fixed Income & Options – January 1, 2013

**The challenges for a taxpayer will be ensuring all gains and losses are reported, and most importantly, the taxpayer will need to make decisions about which of the multiple methods of accounting for disposition of assets if utilized for their various investment accounts. <u>The disposition method, however, cannot be elected or changed after a trade has settled.</u> This makes early tax planning a must. <u>The federally mandated default disposition method is first-in, first-out (FIFO)</u>, where transactions will be completed using the oldest tax lot first – the ones that were purchased or acquired first. *In some cases, this method may not be the one with the best tax results*. A CPA (Certified Public Accountant) is the one best qualified to help you decide which method makes sense for you.**

**<u>Some other disposition methods include:</u>**

**Last-in, last-out (LIFO)**: The tax lot(s) with the latest trade date(s) will be disposed, sold, transferred, or exchanged first, based on the order of their acquisition.

**Average Cost (Using FIFO)**: This option is available only for certain types of shares, and reflects the average cost per share, considering all tax lots of a security, even those no longer held by a client.

**High Cost:** The tax lot(s) with the highest unit cost are disposed of first, whether the tax lot(s) are short-term or long-term, for capital gain tax purposes.

**High cost, long term**: The tax lot(s) with the highest unit cost, and produce a long-term capital gain or loss, are disposed of first. If no long-term shares are identified, then the short-term shares with the highest unit cost will be disposed of first or to make up the long-term shortfall as necessary.

**High cost, short term**: The tax lot(s) with the highest unit cost, and produce a short-term gain or loss are disposed of first.

**Low cost**: The tax lot(s) with the lowest unit cost are disposed of first, whether the tax lots are short-term or long-term, for capital gain tax purposes.

**Low cost, long term**: The tax lot(s) with the lowest unit cost, and produce a long-term gain or loss, are disposed of first.

**Low cost, short term**: The tax lot(s) with the lowest unit cost, and produce a short-term gain or loss are disposed of first.

**With the multitude of disposition options, we strongly suggest investors seek the advice of a CPA to determine which method(s) makes sense for you. If you do not advise your broker of the method chosen prior to a transaction, the default FIFO will be used and this cannot be changed after a transaction is completed.**

Beginning in 2013, brokers will also begin reporting on the 1099-B statement the sale by S corporations (other than financial institutions) of securities that were acquired on or after January 1, 2012, and which are sold, redeemed, exchanged in that year and in all subsequent years. C corporations will continue to be exempt from 1099-B reporting. The IRS Form W-9 includes new box designations for S and C corporations. Unless a broker has a W-9 form on file indicating a company is a C corporation, they will be treated as an S corporation for reporting purposes.

This article is only intended to provide a very broad overview of these changes. **There are many additional provisions within the law, including those pertaining to wash sales, short sales, and transfers including gifts, divorce, inheritance, and other types of investment transfers.** Please contact a CPA and do not rely on this article for decisions concerning cost basis. If you would like to discuss your personal investment situation further, please contact my office at 770.931.1414 to schedule a free consultation.

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