



New rules offer easier cost basis reporting

Brokers must track and report cost basis



If you're contemplating selling stock in 2011 and beyond, you should be aware of new federal regulations that give you more flexibility in managing the tax impact of your investment decisions. The new regulations, which went into effect January 1, 2011, require brokers to track your cost basis. Even better, they allow you to determine how your brokerage firm reports the cost basis of a sale. That can be helpful if you want to minimize the amount of gain on which you'll owe federal income tax or maximize a capital loss.

Your cost basis represents the original purchase price of a security plus any commissions or other fees; your adjusted cost basis is that cost basis adjusted for a variety of factors such as stock splits, corporate acquisitions or spinoffs, and reinvested dividends. Until now, reporting the gain or loss from your investments has been your responsibility, and could be very challenging for the average investor. The new regulations should make it easier to record your capital losses or gains accurately on your federal

income tax form.

The Emergency Economic Stabilization Act of 2008 requires that, as of January 1, 2011, U.S. broker-dealers and other financial intermediaries must not only track the adjusted cost basis of their investors' accounts, but also report that basis to investor clients on their 1099 forms and to the Internal Revenue Service. The rules will be implemented over time. They'll apply to shares of individual stocks you buy after January 1, 2011, to investments in mutual funds and dividend reinvestment plans after January 1, 2012, and to bonds, options and other securities bought after January 1, 2013. Shares acquired before January 1, 2011 are exempt from the new rules, as are securities held in retirement accounts.

You can tailor your reporting method to suit your tax situation

The new regulations allow you to determine in advance what accounting method you wish to use for each sale of stock after January 1, 2011. Most broker-dealers will designate a default option to use if you do not specify a method. That default will typically be the so-called FIFO method (an acronym for "first in, first out"), which means that the first shares of a security purchased are considered the first shares sold. However, your broker might also allow you to specify LIFO ("last in, first out") or designate specific shares as the ones sold. In some cases, such as shares bought through a direct reinvestment program, using an average cost basis for all shares may be most convenient (most mutual fund companies already employ this method of calculating cost basis).

You may be able to put in a standing order specifying the method you want to use for all trades, or choose on a case-by-case basis; you may also authorize your financial professional to make that decision for you. The rules permit investors to change the designated method for a given trade until the settlement date (the date on which money actually changes hands, which for a typical stock sale is three days after execution of the trade). After the trade settles, you cannot change your mind about the method used. Brokers also will be required to report losses that are disallowed as a result of a wash sale (which occurs when shares are sold and then repurchased within 30 days).

Because the new regulations don't apply to investments purchased before January 1, 2011, you'll still need to do your own calculations on those transactions. The cost basis information will be included on the 1099 form you receive from your broker for tax year 2011.



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