



Cost Basis Reporting Legislation

Frequently Asked Questions

EFFECTIVE DATES

Question: What are the effective dates for required cost basis reporting for brokers?

Answer:

The Act includes an initial effective date for cost basis reporting for most stocks and applies to stock acquired on or after January 1, 2011; for mutual funds and dividend reinvestment plan stock (or similar arrangements) acquired on or after January 1, 2012; and for debt instruments, options and other covered securities acquired on or after January 1, 2013. The provision is scored to raise \$6.67 billion over a ten year period.

REPORTING RESPONSIBILITY

Question: Who is responsible for cost basis reporting?

Answer:

Under section 6045 ‘broker’ is a term of art

To answer this we need to reflect upon Internal Revenue Code Section 6045 in which ‘broker’ is a term of art. Under this definition, many could be considered ‘brokers’, including some not typically thought of as such, including mutual fund complexes and other payors. Actual reporting obligation generally falls to the last person defined as a broker making the payment to an eligible recipient. Therefore, in terms of responsibility, you can almost think of it like a ‘last in line’ approach. So the responsible party - or broker - can be thought of as the ‘last in line,’ or the one who last delivers payments to the tax payer.

This issue raises both liability and obligation questions. You have to consider this under the relevant law for the special definition of broker under Sec. 6045. You must also distinguish between the legal obligation to prepare and deliver Forms 1099 and the related liabilities for penalties versus the potential contractual obligation for responsibilities and penalties under business arrangements and contracts. In other words, you should consider who the responsible party is under the law for the obligation to deliver the Form 1099s and at risk for penalties versus which 3rd party business relationships or partners are contractually responsible for actual reporting obligation and associated penalties.

In essence, the existing rules under Sec. 6045 that determine the responsibility for providing Form 1099-B and the obligation for related penalties have not changed.

-- There is now an additional obligation to report basis.

Reporting responsibility and liability are existing issues that already come up in existing schemes in the current laws for Form 1099-B gross proceeds reporting under code 6045. Those who currently have both a responsibility and a duty to report cash proceeds correctly will continue to have it. With this new legislation, they additionally will have responsibility to report adjusted gross basis and holding periods correctly. So in essence, the responsibility and penalties have not changed. There is simply an additional obligation to report basis and holding period.

Your duty and the downside risk.

Your principal duty is and remains to report cash proceeds correctly. With the change in law imposed under the Act, you additionally have to report adjusted basis and holding periods. There is, however, increased downside risk. Since basis reporting makes the process more difficult, it increases risk. Some brokers may not be comfortable with nor equipped to process this. So the big issue when you step back is the potential impact of the legislation on the increased downside risk and how it impacts your duty.

New Law Code Sec. 6045A: Additional Risk

And, there is a new penalty risk in Section 6045A regarding transferring information from one broker to another. When reporting corporate actions, issuers of stocks and specified securities will need to comply with new reporting rules under proposed Code Sec. 6045B. Issuers now also need to consider the related penalties. Under this law, issuers need to send reports within the earlier of 45 days of the day of action or 31 days after the close of tax year, and they will be subject to penalties if the reports are not timely or are incorrect.

BIFURCATION OF ACCOUNTS

Question: Why is bifurcation of accounts required? Wouldn't brokers just start tracking based on stock trades on January 1, 2011 forward?

Answer: Generally, you can just look forward. However, mutual funds may elect to include pre January 1, 2012 information in applying FIFO, specific identification or averaging, in which case the historic information matters.

Additionally, since basis reporting had been a customer service, some may care about the older information for historic expanded basis reporting to customers, but it is not required under the Act.

Also, because brokers need only take into account stock and securities acquired after the effective date, this approach emphasizes the potential mismatch issue between the amount brokers report on Forms 1099-B versus the basis amounts taxpayers should report since there is no grandfathering for taxpayers in terms of their own computations of basis under FIFO or the other methods (and they need to take into account the basis of all of their stocks and securities, including those acquired before the effective date of the Act).

INHERITANCE & GIFT SHARES

Question: What, if any, provisions apply when customers acquire shares upon death of a prior owner and ask for adjustments to cost to reflect a "step-up" in basis?

Answer: Gift or inheritance shares are not specifically addressed in this legislation. Because brokers are responsible for reporting adjusted basis under the Act, there is a possibility that broker reporting of basis, adjustments for gifts and inheritance could be required.

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