



Cost Basis Reporting Legislation: Passed by U.S. House in May 2008

By Stevie D. Conlon

U.S. House Passes Cost Basis Reporting Proposal

Cost basis reporting appears even closer to becoming law. On Thursday, May 8, the U.S. House passed cost basis reporting (the May 2008 version of cost basis reporting) as part of the American Housing Rescue and Foreclosure Prevention Act of 2008 (H.R. 3221). The vote was 322 in favor and 94 against.

Cost basis reporting had been included as a revenue raiser in the Housing Assistance Tax Act of 2008 previously approved by the House Ways and Means Committee in April (H.R. 5720). It was added as an amendment to an earlier House bill (H.R. 3221) that had already been amended by the Senate and then passed by the House. The amended bill will now be considered by the Senate. The president has indicated that he would veto the House's Housing Bill, which means the likelihood of this particular bill and the inclusion of cost basis reporting becoming law as part of it is unclear at best.

Despite the uncertainty of this bill, the fact that the cost basis reporting proposal has been included in a bill passed by the House in 2008 is extremely significant. As previously noted, cost basis reporting was also included in two separate bills that were passed by the House last year (but died at the close of last year's legislative session). It was also included and then later dropped from conferee discussions on the Farm Bill in April of this year. And on May 9, a key legislative staffer indicated that the chances for passage of cost basis reporting in 2008 are highly likely. It has been suggested that cost basis reporting could be included in other congressional bills if it is not made law as part of the Housing Bill.

Latest Proposed Effective Dates

The details of the May 2008 version of cost basis reporting generally tracks the details discussed in our February 2008 whitepaper. One key difference is that the proposed effective dates for the proposal are different—under the May 2008 version, cost basis reporting would be effective for stocks acquired on or after January 1, 2010; for shares eligible for averaging (such as open-end mutual fund and DRIP shares) it would apply to shares acquired on or after January 1, 2011, and for debt, options and other instruments it would apply for such securities acquired on or after January 1, 2012.

On another note, brokers had previously complained about the current January 31 deadline for delivering Form 1099-B information returns to taxpayers. They were concerned that there was little time to compile information and prepare the returns after the close of the calendar year. The May 2008 version of cost basis reporting sought to address this concern by pushing back the deadline for delivering Form 1099-B information returns (and related consolidated reporting statements) to taxpayers from January 31 to February 15— and the latest version of the bill passed by the House on May 9 accelerates the effective date of this provision to returns furnished starting in 2009 (and brokers would have until February 15, 2009 to deliver such returns rather than until January 31).

Other Important Changes—Dividend Reinvestment Plans, Short Sales and Options

The May 2008 version of cost basis reporting includes several other changes. The most important change relates to stock that provides for a dividend reinvestment plan (DRIP). A DRIP is defined under the proposal as “...any arrangement under which dividends on any stock are reinvested in stock identical to the stock with respect to which the dividends are paid.” Under the revised proposal, stock that is part of a DRIP is eligible for averaging, according to the rules available under the provision for open-end mutual fund shares. This is a significant expansion of the availability of cost basis averaging and addresses broker concerns regarding the potential difficulties of computing the specific basis of additional purchases of shares under a DRIP. In general, the special DRIP averaging provision applies to shares acquired after December 31, 2010. Like the open-end fund averaging provisions, brokers decide whether to elect to use averaging (on a stock-by-stock and taxpayer-by-

taxpayer basis) unless the customer notifies the broker that he or she has selected another method. As is the case with open-end mutual fund shares, the broker can elect to include pre-January 1, 2011 shares in averaging computations. The provision also clarifies that the averaging pool includes the initial shares purchased, as well as the subsequent shares acquired when dividends are reinvested.

In addition to the change relating to DRIPs, the timing of short sales reporting was clarified. Under the May 2008 version of cost basis reporting, a short sale (both cost basis and proceeds information) is reported in the year the short sale is closed.

The cost basis reporting provisions also added information reporting for options. The May 2008 version of cost basis reporting revised the option provisions to clarify the reporting of cash settled options.

Other than these changes, the other cost basis reporting provisions remained essentially unchanged.

Conclusion

Given the passage by the U.S. House of Representatives of the May 2008 version of cost basis reporting, its inclusion in conference discussions of the 2008 Farm Bill and statements of several key legislative staffers and administration tax officials, the likely enactment of cost basis reporting seems better than ever. And given the relatively minor revisions to the provisions of the cost basis reporting included in the May 2008 version, it would appear likely that the key provisions of the proposal will essentially track the May 2008 version except for effective dates. The effective dates may be pushed back if the proposal is not enacted in the next six months. However, given the history of the proposal, brokers are likely to be given less than two years to prepare under any revised effective date.

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