



Tax Alert

Tax Court Sustains IRS “zero cost basis” Deficiency Against Taxpayer

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When a taxpayer fails to file a tax return, the IRS will calculate the amount of tax due. In calculating the tax due under such circumstances, it is common for the IRS to compute capital gains on stocks (and securities) based on Form 1099-B gross proceeds information while assuming that the taxpayer's basis in such stock is zero.

The IRS approach could be considered extremely punitive because a taxpayer could have substantial basis in such stocks. If cost basis is taken into account, the computed tax deficiency relating to capital gains could be substantially reduced and it is possible that some computed capital gains could really be capital losses.

In order to overcome the IRS determination of zero basis in such cases, the taxpayer has the burden of proof and has to prove that he or she has a basis in such stock that is greater than zero.

A recent Tax Court memorandum decision, *Stanley A. Cook v. Commissioner*, T.C. Memo 2008-182, No. 24547-06 (July 30, 2008), serves as a reminder that the courts continue to support the IRS "zero basis" approach. In this case, the IRS computed a \$972 capital gain based on proceeds and an amount realized of \$972 and a basis of zero in Mr. Cook's Sonera stock. On his late Form 1040, Mr. Cook reported an amount realized of \$972.79 and a cost basis in the stock of \$3,400.72, resulting in a capital loss of \$2,427.93.

Noting that the IRS determinations control unless the taxpayer proves a basis of greater than zero, the judge indicated that Mr. Cook had not provided any evidence to the IRS or to the court to substantiate his \$3,400.72 claimed cost basis in the Sonera stock or the resulting \$2,427.93 capital loss. Accordingly, the court sustained the IRS determination of a zero basis in the stock and the \$972 capital gain.

Conclusion

The Tax Court's recent decision in *Cook v. Commissioner* is a stark reminder of the importance of timely filing your tax return, the risk of an IRS zero cost basis determination, and the need to maintain records and proof of the cost basis of stocks and securities.

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