

**Shareholder Communications for Cost Basis Reporting**  
**ICI Transfer Agent Advisory Committee (TAAC)**  
**Cost Basis Reporting Task Force**  
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**Table of Contents**

**I. Introduction**

**II. Information for all Communications on Cost Basis Reporting**

**III. General Cost Basis Reporting Information**

**IV. Fund Policies for Cost Basis Reporting**

1. Disclosure of the fund's default cost basis reporting method
2. Cost basis reporting methods supported as standing instructions
3. Lot depletion method used by funds for covered and noncovered shares
4. Single account election – fund choice to combine covered and noncovered shares when shareholder has selected average cost
5. Cost basis reporting considerations for shareholder account options
6. Cost basis reporting considerations for non-shareholder generated activity

**V. Shareholder Specific Elections**

1. Selecting a cost basis reporting method other than the fund's default method
2. Blanket elections
3. Confirmation of the cost basis reporting method selected by the shareholder
4. Changing cost basis reporting methods, including a change to/from average cost
5. Revocation of a shareholder's average cost election
6. Confirmation of shareholder's revocation of average cost

**VI. Trade Specific Information – Redemptions and Transfers**

1. Providing lot depletion instructions when using true specific ID
2. Transfers of inherited shares
3. Transfers of gifted shares

**VII. S Corp Solicitations, 1099B Reporting and Other Communications**

1. S Corp Solicitations
2. 1099B Reporting
3. Hypothetical cost basis calculator tool (if offered)

## **I. Introduction**

The ICI Transfer Agent Advisory Committee (“TAAC”) formed a Cost Basis Reporting Task Force in 2008 to provide ICI member input on the evolving cost basis reporting regulations and to provide a forum to address the operational challenges faced by funds as they implement the final cost basis reporting rules.

The TAAC Cost Basis Reporting Task Force developed this document, Shareholder Communications for Cost Basis Reporting, to assist ICI members as they craft their communications for fund shareholders on mandatory cost basis reporting. The document identifies and categorizes important cost basis reporting concepts that funds may want to include in their communications with shareholders. This document is intended to serve as a resource for ICI members but may not include all concepts that an individual fund should or may wish to communicate to its shareholders. Further, this document does not provide any legal advice regarding the requirements or proper interpretation of the cost basis reporting rules. Funds may wish to consult their counsel before implementing any shareholder communications.

Questions or comments on this document may be directed to Diane Butler, Director of Transfer Agency and International Operations, at [butler@ici.org](mailto:butler@ici.org) or 202-326-5850.

## **II. Information for all shareholder communications on cost basis reporting**

### **Possible concepts to communicate:**

- Provide a toll-free number for shareholder questions on cost basis reporting.
- Provide a link to the fund website for online cost basis reporting information.
- Include a tax/legal advice disclaimer.

## **III. General Cost Basis Reporting Information**

### **Possible concepts to communicate:**

- Cost basis reporting is required by federal law.
- The law applies to mutual fund shares purchased after the 1/1/2012 effective date (i.e., covered shares).
- The cost basis reporting regulations treat shares acquired before the effective date of 1/1/2012 as if they are in a separate account from shares acquired after the effective date (i.e., deemed separate accounts).
- Cost basis reporting is not required on shares purchased before 1/1/2012 (i.e., noncovered shares).
- Beginning with the 2012 tax year, 1099B forms will provide cost basis and character of gain/loss (i.e., short-term or long-term) information to both fund shareholders and the IRS for covered shares.
- The deadline for mailing 1099B tax forms to fund shareholders was changed from January 31 to February 15, and first became effective in 2009 for the 2008 tax

- year. The February 15 deadline also applies to other tax forms (e.g., Form 1099-DIV) that may be sent in a consolidated reporting statement with the 1099B.
- The taxpayer filing deadline has not changed as a result of the cost basis reporting regulations.

#### **IV. Fund Policies for Cost Basis Reporting**

##### **1. Disclosure of the fund's default cost basis reporting method**

###### **Possible concepts to communicate:**

- Define covered and noncovered shares. Include the distinction between pre-effective date shares and other noncovered shares.
- Describe the fund's default cost basis reporting method for covered shares.
- Explain when the default cost basis reporting method will be used (i.e., unless the fund accountholder selects a cost basis method).
- If the mutual fund's default method is average cost, explain consequences if the account holder does not affirmatively elect another method in writing (i.e., all shares in the account will have a basis equal to the average, and account holder may change methods prospectively only).
- Disclose if cost basis for pre-effective date/noncovered shares will be voluntarily reported to the shareholder and/or the IRS, and describe the cost basis reporting method that will be used.
- Provide hypothetical examples.

##### **2. Cost basis reporting methods supported as standing instructions**

###### **Possible concepts to communicate:**

- Explain what standing instructions for cost basis reporting are and how they work.
- Identify and describe the standing instruction methods supported by the fund for cost basis reporting (e.g. FIFO, LIFO, HIFO, etc.).
- Provide examples to show how the available cost basis reporting methods work.
- Provide instructions for how to select/change a standing instruction method.
- Provide the timeframes/deadlines for selecting a standing instruction method.

### **3. Lot depletion method used by funds for covered and noncovered shares**

#### **Possible concepts to communicate:**

- Define covered and noncovered shares.
- Explain what is meant by lot depletion method.
- Describe the lot depletion method that will be used for partial redemptions or transfers if the shareholder does not provide instructions regarding which account (i.e., noncovered or covered) to deplete first.<sup>1</sup>
- Describe the fund's default cost basis reporting method for covered shares and the associated lot depletion method for partial redemptions or transfers. For example, when using average cost, lots will be depleted in date order (i.e., FIFO).

### **4. Single account election - fund choice to combine covered and noncovered shares when shareholder has selected average cost**

#### **Possible concepts to communicate:**

- Define the terms “single account election,” “covered shares” and “noncovered shares.”
- Disclose the fund policy for making single account elections. Clearly state that the fund cannot revoke the single account election once it has been made.
- Describe when the single account election can be made by the fund, as follows:
  - Shareholder has affirmatively elected average cost (i.e., the single account election may not be used with other cost basis reporting methods or with a fund default to average cost)
  - Cost basis information on noncovered shares meets the accuracy standard in the final rules (i.e., the fund neither knows nor has reason to know that the information is incorrect) and clarified in IRS FAQ 55<sup>2</sup>
  - Noncovered shares must be non-certificated
- Describe the shareholder's role in the fund decision to make a single account election. (e.g., Can shareholder opt in/out?)
- Describe how the fund will determine the accuracy of cost basis information for noncovered shares, including the shareholder's role in the process.

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<sup>1</sup> The cost basis reporting regulations say that, absent shareholder instruction, brokers must deplete lots for a partial redemption or partial transfer by depleting unknown acquisition dates first, followed by date order (i.e., FIFO), whether noncovered or covered. The regulations and the IRS FAQs are clear that FIFO applies on an account-by-account basis, so brokers can choose which account (i.e., covered or noncovered) to use first after depleting the unknown. The recommended industry best practice is to delete noncovered before covered.

<sup>2</sup> Question 55 notes that brokers should exercise caution in making a single-account election for mutual fund shares if it is possible that the taxpayer may have averaged the basis of noncovered shares subject to the election with the basis of stock held by other brokers. For noncovered shares, a taxpayer makes the average cost election on the taxpayer's tax return, and, for shares sold before 2012, the taxpayer is required to average the basis of all identical stock held in any account. Therefore, it is possible that the shareholder may have redeemed identical shares in an account held with another broker, thereby affecting the average basis of all the taxpayer's shares in that fund. For the broker making the single-account election, the basis information for the noncovered shares thus no longer would be accurate. The Cost Basis Reporting Overview and FAQs can be found at <http://www.irs.gov/taxpros/article/0,,id=237099,00.html>.

- Disclose the fund policy for accepting shareholder provided cost basis information where there is incomplete or inaccurate information.
- Disclose the fund policy for revocations of the average cost election by a shareholder, and how revoking average cost affects the single account election.
- Explain that prospective changes from average cost to another method do not affect the single account election (i.e., shares will remain covered).
- Discuss the impact of shares subsequently acquired with no cost basis information (i.e., will be new noncovered in a deemed separate account unless another single account election is made).
- Disclose the method that will be used to communicate that the single account election has been made by the fund.
- Provide hypothetical examples.

## **5. Cost basis reporting considerations for shareholder account options**

### **Possible concepts to communicate:**

- Identify the shareholder account options that may be affected by the accountholder's choice of cost basis reporting method, including:
  - Systematic withdrawal plans (SWPs)
  - Automatic exchange (i.e., redemption from one fund and purchase into another fund on a set frequency)
  - Automatic rebalancing
  - Exchanges, redemptions or SWPs by interactive voice response (VRU) or fund website
  - Checkwriting or debit card transactions (on 1099B reportable funds)
- Describe the fund policy for offering shareholder account options to accountholders that have selected the true specific identification (“true specific ID”) cost basis reporting method, which is where the accountholder selects the lots to be sold at the time of each redemption or exchange transaction.
- If the fund offers these account options to shareholders using true specific ID, describe the lot depletion method the fund will use for these transactions in the absence of shareholder identification prior to the transaction.
- For shareholders that have elected average cost, discuss the impact of automatic transactions on the revocation period.

## **6. Cost basis reporting considerations for non-shareholder generated activity**

### **Possible concepts to communicate:**

- Define and provide examples of non-shareholder generated activity (e.g., redemptions for disclosed shareholder expenses).
- Disclose that 1099B reporting is required on the disposition of shares for non-shareholder generated activity.
- For shareholders that have elected true specific ID, disclose what lot depletion method will be used for these transactions (i.e., the funds default method or another method if the fund's default method is average cost).

- If offered, describe the fund option to allow shareholders to prepay fees so that share balances are not impacted and cost basis reporting is not required.
- For shareholders that affirmatively elect the average cost method, disclose whether non-shareholder generated transactions will affect their ability to revoke the average cost election.

## V. Shareholder Specific Elections

### 1. Selecting a cost basis reporting method other than the fund's default method

#### **Possible concepts to communicate:**

- Describe the cost basis reporting methods available to the shareholder, including the standing instruction methods supported by the fund.
- Provide instructions for how to affirmatively select a cost basis reporting method other than the fund's default method.
- Explain how to fulfill the in-writing requirement for average cost elections.
- For shareholders considering the true specific ID method, explain how and when they will be required to provide lot selection information. Explain what will happen if the shareholder does not provide lot selections within the required timeframe (e.g., the fund may have a default method that will be used absent shareholder instructions).
- Disclose any circumstances where a shareholder's elected cost basis reporting method may not be used (e.g., joint to single tenant, divorce, etc.).
- Provide any forms required for selecting or changing a cost basis reporting method and disclose any time deadlines/constraints.

### 2. Blanket elections

#### **Possible concepts to communicate:**

- Define the term blanket election.
- Describe the fund policy with respect to accepting blanket elections, including the cost basis reporting methods that blanket elections can be used with, whether they are accepted on accounts with the same or similar registrations, and whether they are accepted on future accounts.
- Provide instructions for how to make a blanket election.

### 3. Confirmation of cost basis reporting method selected by the shareholder

#### **Possible concepts to communicate:**

- The cost basis reporting method selected (i.e., both a new election and a change of method).
- The shareholder account(s) that the cost basis reporting method election applies to.
- The effective date on which the fund will begin using the selected cost basis reporting method.

#### **4. Changing cost basis reporting methods, including a change to/from average cost**

##### **Possible concepts to communicate:**

- Provide instructions for how to change cost basis reporting methods.
- Provide instructions for requesting a change from/to average cost in writing. Note that a shareholder instruction to change from average cost must be in writing, whether the shareholder was defaulted to or selected the average cost method.
- Disclose when a shareholder must change, rather than revoke, their average cost election (e.g., the revocation period has expired, a redemption of covered shares has occurred, or the shareholder was defaulted to average cost).
- For a change from average cost, disclose that the change will be prospective only and will not affect the basis of the shares in the account prior to the change.
- Disclose how the fund will confirm the change in cost basis reporting method.

#### **5. Revocation of a shareholder's average cost election**

##### **Possible concepts to communicate:**

- Describe what revocation is and disclose that only those shareholders that affirmatively elect average cost may revoke their election.
- Disclose the fund policy for when shareholders may revoke an average cost election (i.e., the fund may extend the right to revoke beyond one year, but not beyond the first redemption of covered shares).
- Disclose if other transaction types end the revocation period (e.g., fund to broker transfers, B to A rolls, etc.).
- Provide instructions for revoking an average cost election. Note that the instruction to revoke must be made in writing and disclose the fund policy for methods of communication that meet the in writing standard.
- Explain the effect of a revocation on the basis of shares in the account.
- If the single account election was made by the fund, explain that revoking the average cost election will also cause the fund to unwind the single account election.

#### **6. Confirmation of Shareholder's Revocation of Average Cost**

##### **Possible concepts to communicate:**

- Confirm that the shareholder's average cost election has been revoked.
- Provide the date of the original average cost election and the date of the revocation request.
- Verify the cost basis method that was elected in place of average cost.
- Provide information on the share lots to which the new method will be applied.
- If applicable, disclose that the single account election made by the fund has been unwound.

## **VI. Trade Specific Information – Redemptions and Transfers:**

### **1. Providing lot depletion instructions when using true specific ID**

#### **Possible concepts to communicate:**

- Provide instructions for communicating lot selections for redemption or transfer requests, including:
  - How to determine what lots are available
  - How to advise the fund company of lot selections
  - Lot selection forms and instructions, if applicable
  - Timing requirements for lot selections
  - Special instructions for redeeming online
  - Special instructions for telephone redemptions
- Disclose how lots will be selected for systematic transactions (e.g., SWPs) in the absence of shareholder identification prior to the transaction.
- Disclose how lot selections will be confirmed to the shareholder.
- Disclose fund policy for corrections and changes to lot selections.
- If permitted, provide instructions and timeframes for making lot selection corrections or changes.

### **2. Transfers of inherited shares**

#### **Possible concepts to communicate:**

- Describe the default rules for inherited shares provided in the final cost basis reporting rules (i.e., adjusted basis equal to the fair market value on the date of death with a long-term holding period).
- Disclose that funds will be using the default rules for determining the cost basis of inherited shares, unless instructions are received from a representative of the decedent's estate.
- Provide instructions for how estate representatives can communicate cost basis information to the fund.
- Disclose how transfers of inherited shares from/to a joint account will be handled.
- Discuss special considerations for lot depletion for partial transfers of inherited shares (e.g., where there are two or more inheritors lots may be split).

### **3. Transfers of gifted shares**

#### **Possible concepts to communicate:**

- Disclose that funds generally must treat all transfers between accounts with different owners as gifts unless the shareholder provides information to the contrary. Note exceptions, for example funds will not treat as gifts transfers between accounts with a common owner, or transfers between spouses.
- Discuss special considerations for the depletion of lots for partial transfers of gifted shares. For example, if the shareholder has selected FIFO and subsequently



gifts shares, the lots with the highest cost will be transferred to the recipient of the gift unless the shareholder provides other instructions.

- Describe how the cost basis and holding period of shares acquired through a gift will be determined by the fund upon redemption (e.g., if the shares were gifted at a loss, either the fair market value at the date of the gift or the donor's cost basis may be used, depending on the fair market value at the time of redemption).
- Disclose that for shares gifted at a loss, the shareholder may not use average cost for their basis method unless they notify the fund in writing that they will use the fair market value on the date of the gift as the basis for those shares.

## **VII. S Corp Solicitations, 1099B Reporting and Other Communications**

### **1. S Corp Solicitations**

#### **Possible concepts to communicate:**

- S Corps are now subject to 1099B reporting.
- Provide instructions for how to recertify/communicate your S Corp or C Corp status (i.e., complete a new W-9).
- Provide the new W-9 and related instructions.
- Explain why S Corps need to provide new W-9s (i.e., to verify that the fund has the correct TIN in order to avoid back-up withholding).
- Explain why C Corps need to provide new W-9s (i.e., if corporate status is not known funds are required to treat them as S Corps and to perform 1099 reporting and possible back-up withholding).
- If money market fund shareholders are included in the S Corp solicitation, explain why (e.g., may exchange into a 1099B reportable fund).
- Provide S Corps with cost basis reporting information, including the fund's default cost basis reporting method, options/instructions for selecting a cost basis method, new 1099B reporting, etc.

### **2. 1099B Reporting**

#### **Possible concepts to communicate:**

- The effective date for mandatory cost basis reporting on redemptions of fund shares is 1/1/2012.
- The deadline for 1099B reporting is February 15
- Describe the new fields on the 1099B.
- Disclose that the 1099B may include information on both covered and noncovered shares.
- Disclose that what is reported on the 1099B may differ from what the taxpayer is required to report on the Schedule D (e.g., possible differences in reporting for wash sales, gifted and inherited shares).
- Disclose the timeframe for corrected 1099B reporting (i.e., 3 years).
- Discuss the impact to shareholders of receiving a corrected 1099B (i.e., may require amended prior year tax filings).

- Discuss the possible reasons for providing amended 1099Bs (e.g., fund initiated corrections such as returns of capital, amended transfer statements, shareholder initiated corrections, etc.).

### **3. Hypothetical cost basis calculator tool (if offered)**

#### **Possible concepts to communicate:**

- Provide instructions on how to use the tool.
- Provide appropriate disclosures regarding the hypothetical nature of the calculations and the need for shareholders to consult their own tax advisors (funds should consult counsel regarding the proper disclosures).
- Disclose that fund prices used for hypothetical calculations are as of a date and results will change based on the price at the time of redemption.
- Disclose the level of accuracy of the calculation, for example:
  - Does it include wash sales?
  - Does it include sales load basis deferral?
  - Does it include charges, such as CDSCs or redemption fees?
- Future transactions, such as returns of capital, could impact cost basis.
- If hypothetical used specified share lots, disclose that the same lots may not be available at the time of redemption.