

Investment Company Institute Webinar

Implementing Cost Basis Reporting for Mutual Funds

January 5, 2011



Speakers

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Cost Basis Reporting Topics

- An overview of the final cost basis reporting requirements, including outstanding issues and questions for the IRS
- Industry initiatives for automating transfer reporting requirements between brokers
- Mutual fund transfer agent efforts to address shareholder servicing and communication needs
- A fund complex perspective on implementing cost basis reporting
- A roundtable discussion on frequently asked questions

Cost Basis Reporting Overview

Karen Gibian
Investment Company Institute

Cost Basis Reporting: Where Are We Today?

- Effective for fund shares acquired after December 31, 2011
 - Effective for other equities acquired after December 31, 2010
- Proposed regulations issued December 2009
- Final regulations issued October 2010
- No transition relief, but IRS likely will mitigate penalties during early years except for egregious cases

Final Regulations: Average Cost

- Shareholders must elect average cost method *in writing*
 - Writing may be electronic
 - Shareholders may make one election for all accounts with a broker (including future accounts)
- Shareholders may change basis methods without IRS consent
 - Shareholders may change method on a sale-by-sale basis

Final Regulations: Single-Account Election

- Broker may make the election only for accounts for which the shareholder has affirmatively elected average cost
 - Shareholder revocation of average cost election voids single account election
- Accuracy requirement for pre-effective date shares: “broker neither knows nor has reason to know such information is inaccurate”

Final Regulations: Transfers

- Transfer reporting is not required for accounts exempt from 1099-B reporting (IRAs, money market funds, NRAs)
- Final regulations reduce the amount of information required on a transfer statement.
 - Statement date
 - Name, address and telephone number of person furnishing the statement and broker receiving it
 - Name and account number of customer(s) (both transferring and receiving)
 - CUSIP
 - Transfer and settlement dates
 - Adjusted basis and acquisition date

Final Regulations: Gifted and Inherited Securities

- Final Regulations adopt default rule for inherited securities
 - Fair Market Value on date of death, unless provided with an alternate valuation by an estate representative
- Final Regulations adopt proposed regulations on gifted securities
 - Must report donor's basis and FMV of shares on date of gift
 - Receiving broker must maintain both numbers, as donee's basis may depend on FMV of shares upon a subsequent sale.
 - Even if shares are gifted at a gain, brokers must transfer and carry the FMV on the date of gift, even though that information is irrelevant to any future gain/loss determinations

Final Regulations: Other Changes

- Basis adjustments not required for:
 - Six-month conversion rules
 - Wash sales that occur after shares are moved out of an account
- Cut-offs for Corrections
 - Three years for 1099-Bs
 - 18 months for transfer statements
- Corporate action reporting – Applicable to Fund Industry
 - Information may be posted on public website; must be maintained for 10 years
 - Money Market Funds exempt

RIC Modernization Act of 2010

- Returns of Capital

- A non-calendar-year RIC's earnings and profits are allocated first to distributions made on or before December 31 of that taxable year and then to distributions made thereafter.
- Minimizes the possibility that RICs will need to send shareholders an amended IRS Form 1099

- Sales Load Basis Deferral Rule

- Limits the rule's application to cases in which a taxpayer makes a reinvestment triggering the rule by January 31 of the calendar year following the year in which the redemption of the initial investment occurred
- Eliminates the possibility that the sales load basis deferral rule will force a shareholder to amend an income tax return

Final Regulations: Outstanding Issues

- Average Cost as Default Method
 - If the shareholder does not affirmatively elect a method, and the broker uses average cost as its default, the shareholder may change from average cost *prospectively* only, even if no redemptions have occurred.
- Single Account Election
 - Shareholders must affirmatively elect average cost before the broker can make the election.
- Choice of Default Method
 - It is unclear whether brokers may choose a method other than FIFO or average cost for mutual fund shares.

Final Regulations: Outstanding Issues

- February 15 Reporting Deadline
 - Final regulations may preclude IRA custodians from consolidating tax information with taxable accounts
- Gifted Securities
 - Although donees typically take on the holding period of the donor, the holding period may be short term if (i) the shares are gifted at a loss and (ii) the donee recognizes a loss upon a subsequent sale.
- Inherited Securities
 - Final regulations do not differentiate between shares inherited from the decedent and shares acquired by the estate after the decedent's death.

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**Please answer the polling
question.**

Thank you

Cost Basis Transfer Reporting for Mutual Funds

Jeff Naylor
SunGard – Asset Arena

Operational Considerations

- **Systematic Lot Depletion**

- Industry Recommended Practice: Remove non-covered shares FIRST – regardless of method.
- IRS Requirement: Remove unknown basis acquisition date shares FIRST – regardless of method.
- Rationale
 - Enables long-term matching between shareholders and reporting brokers
 - Consistency across reporting brokers
- Impacts
 - Most notably LIFO methods, where, at minimum, unknown basis (non-covered) must be removed before any other share category.
 - Industry recommended practice remains to remove all non-covered shares first, regardless of method.

Operational Considerations

- **Partial Transfers**
 - IRS Requirement: In-Kind partial transfers between reporting Brokers must be moved on a FIRST-IN / FIRST-OUT (FIFO) basis “absent shareholder instruction.”
 - “Shareholder Instruction”
 - Specific Lot Identification
 - Proportional
 - Impacts
 - Mostly operational/training
 - Systems have to support a Specific Lot identification model; proportional is a sub-set of that model
 - No impact to CBRS

Operational Considerations

- **Broker to Broker Transfers**
 - Recommended Practice: Use DTCC CBRS Reporting Service
 - Phase 1 live for Equities
 - Phase 2 (2011 implementation) for Mutual Funds
 - Can be used either in conjunction with DTCC Services like Networking, ACATS Mutual Fund Transfers through ACATS-Fund/SERV or for manual transfers
 - Updates to Fund/SERV and Networking
 - Implementation anticipated mid-year 2011
 - Aligning current Cost Basis-related fields to be consistent with CBRS
 - Adding additional fields to support Underlying Account relationships in both the Omnibus and Agent spaces
 - DTCC Important Notice forthcoming

Operational Considerations

- **Retirement In-Kind Transfer Reporting**

- **IRS Requirement:** When a retirement asset is transferring in-kind into a non-retirement account. Transfer reporting indicating non-covered shares is required.
 - This is more typical of an equity transfer than mutual funds
 - Transfer statement requirement creates complexities for fund families, as most do / will not track cost basis on retirement accounts (exempted from regulation)
- **Recommended Practice – assuming a different reporting broker is recipient**
 - Fund would complete the transfer from the retirement account
 - Receiving reporting broker would initiate a CBRS transfer request to satisfy a regulatory requirement
 - Fund would reject the request, indicating the originating account is exempt from reporting and the shares are non-covered.
 - This specific reject would satisfy the transfer reporting requirement

Operational Considerations

- **DTCC Cost Basis Reporting User Guide and Best Practices**
 - Co-authored by the ICI Broker/Dealer Advisory Committee CBR Task Force
 - Focus is on transfer of mutual fund cost basis between reporting brokers
 - Supplemental to the DTCC CBRS User Guide
 - Contents
 - CBRS layouts from a Mutual Funds perspective
 - Networking, ACATS Fund/SERV and Manual Transfers
 - Key concepts
 - CBRS examples under each product / approach
 - Incorporating cost basis calculation methodologies
 - Impact of Agent and Omnibus requirements
 - Return of Capital and Wash Sale considerations
 - Publication anticipated 2nd quarter 2011 through the DTCC

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question.**

Thank you

Transfer Agent Advisory Committee CBR Task Force Update

Charles Hawkins
BNY Mellon Asset Servicing

CBR Task Force Update

- June – December 2010 Activity
 - Survey
 - Shareholder communications
 - Analysis of final regulations and questions/answers development

CBR Task Force Update

- January – June 2011 Activity
 - Publish shareholder communications document
 - Publish frequently asked questions document
 - Revisit fund preparation checklist
 - Potential survey

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question.**

Thank you

A Fund Complex Perspective on Implementing Cost Basis Reporting

Nino Palermo
American Funds

Fund Company Concerns

- Choosing a default method
 - Bifurcated Average Cost or “FIFO”?
- “Blanket” Elections
 - What does it all mean?
- S Corp Solicitations
 - When, How and How Many?
- Single Account Elections
 - To solicit or not solicit?

Fund Company Concerns

- Transfer Upon Death
 - Estate “representative” instructions
- Community Property States
 - Transfer reporting rules
- Internal Training
 - Specialized queue or all associates?
- FAQs
 - What can we answer?

Roundtable Discussion on Frequently Asked Questions

Kathy Joaquin
Investment Company Institute

Roundtable Discussion on Frequently Asked Questions

- The final regulations contain an accuracy requirement for basis reporting – brokers are not subject to penalties for incorrect basis information if they “neither know nor have reason to know” that such information is incorrect. How is this accuracy requirement applied to:
 - Single Account Election
 - Shareholder-provided information
 - Other information held by the broker but which the broker is not legally required to use

Roundtable Discussion on Frequently Asked Questions

- How are the basis reporting requirements applied to fund-initiated redemptions?
- How are basis corrections handled if the shares subsequently have been transferred?
- What constitutes an “electronic” writing for purposes of the average cost election by shareholders?

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question.**

Thank you

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Questions ???

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