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AUGUST 26, 2011

Changes to Cost Basis Rules Provide Investors More Flexibility

By Karen Lau Gibian

In a positive development for fund shareholders, the Department of the Treasury and the Internal Revenue Service have issued new cost basis reporting rules that enhance a fund's ability to provide shareholders with average cost basis information. Fund shareholders have become quite familiar with average cost basis information, which many funds have been providing to their shareholders voluntarily for 20 years or more. The regulatory change makes it more likely that funds will continue to use this method as their default method for redeemed shares.

Earlier this year, ICI urged Treasury and the IRS to make such changes to the existing rules, which limited shareholders' ability to choose cost basis methods for fund shares. In a comment letter filed last week, we applauded regulators for doing so. The new rules, we said, "are workable and resolve a significant issue for our industry."

Some background on cost basis: the term generally refers to the purchase price of a mutual fund share. This is essential information for fund investors, because the amount of taxable gain or loss on the sale of fund shares is determined by the difference between the cost basis of the shares and the sale price. If there were fees or commissions paid at the time of purchase, they are included in the basis. You can learn more about cost basis and other important tax considerations for fund investors in this set of FAQs.

In 2008, Congress passed a law that requires brokers and mutual funds to report—to shareholders and to the IRS—the shareholders' cost basis when shares are redeemed. This rule is effective for shares of mutual funds, closed-end funds, and most exchange-traded funds acquired on or after January 1, 2012. It applies to other equities purchased on or after January 1, 2011.

Our recent letter, which addresses implementation of this law, urges several more fixes to the cost basis regulations beyond the recent ones on cost basis method. One is to eliminate the requirement that shareholders must provide written notifications to brokers or funds when they want to elect average cost, revoke that election, or change from average cost to another method. Given that a significant portion of customer communication, including orders for redemptions, occurs over the phone, we noted that requiring such notifications in writing is unnecessarily burdensome and potentially costly for shareholders. In the words of our letter:

Some shareholders may not have immediate access to any means for sending their election or change in writing. If the shareholder is redeeming shares, this processing delay may expose the shareholder to market fluctuations that may produce investment losses. In market conditions like the present, such losses can be significant. Forcing investors to bear market risk to preserve an unnecessary writing requirement makes no sense.

Brokers and funds have procedures and controls in place to handle, securely and efficiently, redemptions and share exchanges that take place over the phone. Similar procedures and controls easily can be applied to shareholder requests to elect or change basis methods. As an alternative to requiring written notification by shareholders, we suggested that the proposed regulations instead permit brokers to provide customers with written confirmations of their average cost elections, revocations, or changes in method. Brokers and funds already provide such confirmations with many routine customer requests such as shares exchanges or address changes. Broker confirmation of a shareholder method election, revocation, or change will provide adequate documentation of the shareholder's request without overburdening the customer.

- Read ICI's letter.
- Learn more about ICI's tax policy work.

- Read “Frequently Asked Questions About Taxation for Mutual Fund Investors.”
- Browse more recent ICI comment letters.

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