

ICI VIEWPOINTS

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ICI Urges Change in Cost Basis Rules to Avoid Harm to Fund Investors

By Karen Lau Gibian

A provision in the new cost basis rules could hurt fund investors. [We recently contacted](#) the Internal Revenue Service (IRS) and the U.S. Department of the Treasury, urging them to amend the rules to avoid this outcome.

Here's the situation. The final regulations on cost basis reporting effectively require shareholders to choose a method for calculating cost basis immediately upon opening a new account or acquiring securities in an existing account, if the broker or fund's default method is average cost. If the taxpayer doesn't choose another method at that time, he or she can later make that choice prospectively only (even they haven't yet redeemed any securities from the account). Thus, the provision eliminates that taxpayer's opportunity, when he or she redeems shares, to choose which cost basis method to use—and consequently which shares to redeem. (Note: this rule only applies to fund shares acquired on or after January 1, 2012.)

For example, suppose a taxpayer purchases 100 shares in Fund A in 2012 for \$10.00 per share. The broker's default method is average cost, and the shareholder does not affirmatively elect a method at that time. In 2013, the taxpayer buys an additional 100 shares in Fund A for \$15 per share. In 2014, the taxpayer informs his broker that he wishes to sell 50 of the shares purchased in 2013 at \$15 per share. Under this rule, however, the broker must use the average cost method, selling 50 shares at \$12.50 per share.

Because this provision was not included in the proposed regulations, we had no chance to comment on it earlier. Given the detrimental effect on fund investors, we're urging the IRS and the Treasury Department to announce promptly that brokers and funds that choose average cost as their default method may allow their customers to select any other basis method for existing shares until the time of the first redemption from that account.

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