

Welcome to the
Cost Basis Reporting Workshop

MARCH 31, 2011
IRVINE, CA

Welcome and Opening Remarks

Kathleen C. Joaquin
Director—Operations & Distribution
Investment Company Institute

Question for the Audience

- Please identify your role:
 - Fund Complex – Operations
 - Fund Complex – Legal/Compliance/Tax
 - External Service Provider (e.g., Transfer Agent)
 - Intermediary – Broker/Dealer or Bank/Trust
 - Independent Director
 - Other

Cost Basis Reporting Methodologies— Special Considerations for Average Cost

Kathleen C. Joaquin, Moderator
Investment Company Institute

Jeff Cook
DST Systems, Inc.

Deanna Flores
KPMG LLP

Karen Gibian
Investment Company Institute

Charles Hawkins
BNY Mellon Asset Servicing

Laura Stanley
Invesco

CBR Methodologies - Special Considerations for Average Cost

- Average Cost as a Default Method
- Single Account Average Cost
- Blanket Elections
- Specific Identification and Standing Orders
- Lot Depletion
- Changes and Revocation Policies
- Other Open Issues with IRS & Treasury
- Operational Challenges

Average Cost as Default Method

Average Cost as Default Method

- If a broker selects average cost as its default method, the shareholder must affirmatively elect a method when the account is opened, for new accounts, or when covered shares are first acquired in an existing account.
- If the shareholder does not immediately elect another method, the shareholder may change from average cost prospectively only, even if no redemptions have occurred in the account.

Average Cost as Default Method

- Example:
 - Assume a customer opens a new account with Broker A and purchases 100 shares in Fund X in 2012 for \$10 per share.
 - Broker A's default method is average cost, and the customer does not elect a method.
 - In 2013, the customer buys another 100 shares in Fund X for \$15 per share.

Average Cost as Default Method

- Example (cont'd)
 - In 2014, the customer informs Broker A that he wishes to sell 50 of the shares purchased in 2013 at \$15 per share.
 - Under the final regulations, Broker A must use the average cost method, selling 50 shares at \$12.50 per share.
 - The customer may use specific identification going forward, but the existing shares in the account are treated as one lot with a basis of \$12.50 per share.

Average Cost as Default Method

- The final regulations are detrimental to fund shareholders.
- This rule contradicts other regulations that permit shareholders to choose a basis method up until the date of settlement.
- The final regulations effectively may limit funds' and brokers' ability to use average cost as a default method.

Average Cost as Default Method

- ICI asked the IRS to provide that brokers and funds may allow their customers to choose any method for all fund shares in an account, until the first redemption, regardless of default method.
- A possible solution is to clarify that a broker is not required to apply its default method until the time of the first redemption.
 - This would allow shareholders to choose another method at that time.
 - If the shareholder doesn't specify a method, the broker's default of average cost would apply.

Single Account Average Cost

Single Account Average Cost

- Final Regulations state the shareholder must first affirmatively elect average cost in writing.
- The broker or fund can then make the election to treat all shares as a single account without regard to the date acquired.
- All shares become covered shares.
- Funds and brokers have an accuracy requirement. Information is accurate if they neither know nor have reason to know the basis information is inaccurate.

Single Account Average Cost

- Notification requirement to the shareholder of the election.
- Once made, the broker or fund cannot revoke the election.
- The shareholder is allowed to revoke the average cost election and the broker's single account election is then void. Pre-effective date shares revert back to noncovered.
- The shareholder is allowed to change accounting methods prospectively. However, all shares stay covered and keep their cost at the average.
- Single account election applies only to accounts with the same ownership type.

Blanket Elections

Blanket Elections

- A shareholder is allowed to make one average cost election in writing that encompasses all accounts with that custodian or agent.
 - The Blanket election can include any future accounts opened.
 - The blanket election may allow new accounts opened via telephone exchange or some automated way to have the average cost election without having to get it in writing for each new account.
- Scope of the blanket election:
 - Individual fund's interpretation of agency law.
 - Could be limited only to exact same ownership type or expanded to same name/TIN or to accounts with same trading authority.

Specific ID and Standing Orders

Specific ID and Standing Orders

- Shareholders are allowed to specifically identify the lots and associated costs of shares redeemed.
- Lots must be specifically identified no later than the settlement date for the sale or transfer.
- To accommodate systematic transactions, a secondary choice for lot depletion could be used when it is not practical to specifically identify lots at redemption time.
- A standing order (such as HIFO or LIFO) is considered an adequate identification of shares.
- Specific identification of lots must be confirmed.
- Funds are not required to accept all standing order requests.

Lot Depletion

Lot Depletion

- The final regulations provide definitive guidance for certain lot depletion situations.
- Average Cost -- shares are depleted in FIFO order.
- Other methods -- shares are depleted in the order according to the method.
- If an adequate and timely specific identification of shares is not made at the time of redemption, any lots with unknown acquisition dates must be depleted first, followed by any other lots in FIFO order.
- Depletion order for noncovered vs. covered accounts:
 - Could be based on shareholder choice or based on fund policy and default rules. Communication is key!

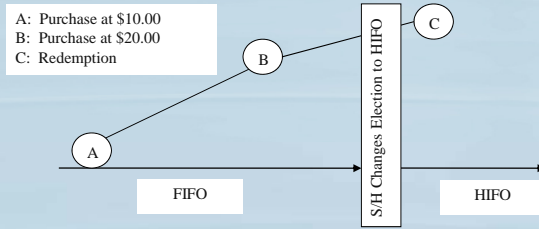
Changes and Revocations

Changes

- Available for all cost basis methods
 - Change to or from average cost, shareholder election must be in writing (electronic OK)
- Applies to future redemptions only
 - Must be made prior to redemption settlement date
 - Does not impact the cost of previously acquired shares

Changes

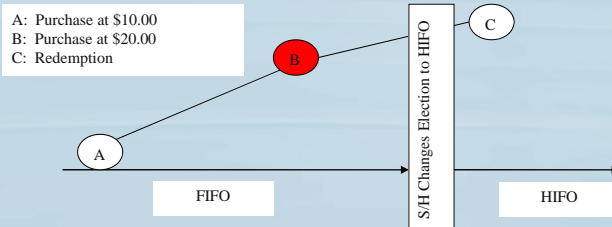
Changes: Shareholder changes election prior to redemption



Which lot gets depleted?

Changes

Changes: Shareholder changes election prior to redemption

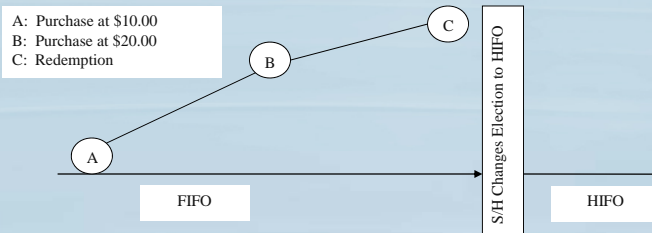


Which lot gets depleted?

Solution: Fund depletes lot B.

Changes

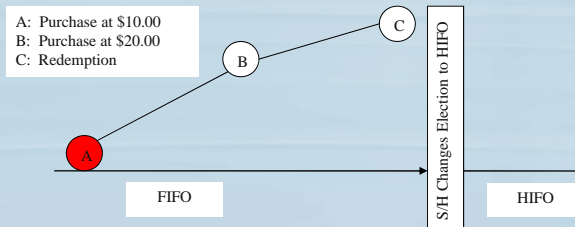
Changes: Shareholder changes election after redemption



Which lot gets depleted?

Changes

Changes: Shareholder changes election after redemption



Which lot gets depleted?

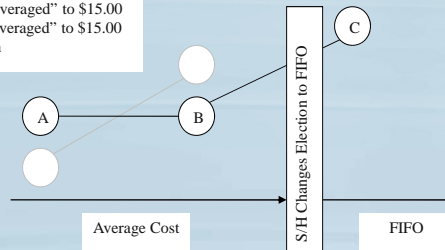
Solution: Fund depletes lot A.

(Fund may not apply the shareholder instruction retroactively after the redemption.)

Changes

Changes: Shareholder changes from average cost to FIFO prior to redemption

- A: Purchase "averaged" to \$15.00
- B: Purchase "averaged" to \$15.00
- C: Redemption

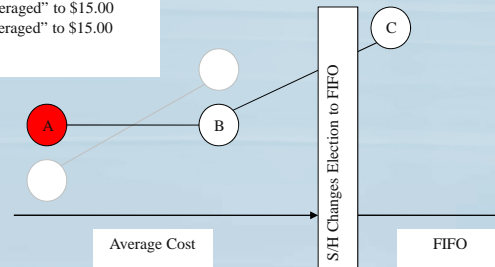


Which lot gets depleted?

Changes

Changes: Shareholder changes from average cost to FIFO prior to redemption

- A: Purchase "averaged" to \$15.00
- B: Purchase "averaged" to \$15.00
- C: Redemption



Which lot gets depleted?

Solution: Fund depletes lot A, at the average cost price of \$15.00.

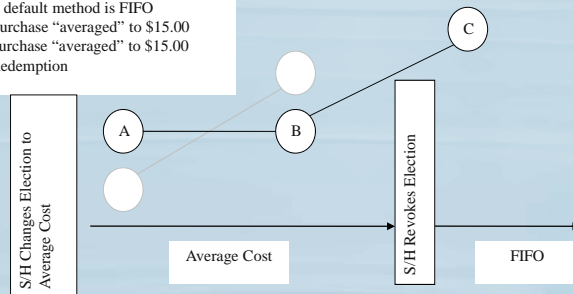
Revocations

- Applicability
 - Only relate to shareholder elections to use average cost
 - Shareholder can only revoke an election they have made (not a fund default)
 - Revocation must be in writing
- Impact
 - Retroactive to the point at which the shareholder made the election
 - Unwinds the “averaging” adjustment to purchases
- Timing Restriction
 - Revocation must be received by the earlier of
 - 1 year from the date the election was made; or
 - The settlement date of the first redemption or transfer

Revocations

Revocation: Shareholder revokes an average cost election timely

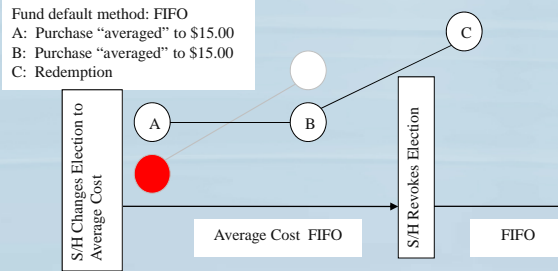
Fund default method is FIFO
 A: Purchase “averaged” to \$15.00
 B: Purchase “averaged” to \$15.00
 C: Redemption



Which lot gets depleted?

Revocations

Revocation: Shareholder revokes an average cost election timely

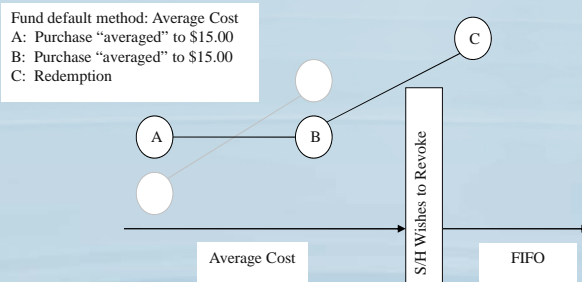


Which lot gets depleted?

Solution: Fund depletes the purchase at the original, not averaged, price.

Revocations

Revocation: Fund default is average cost; shareholder wishes to revoke

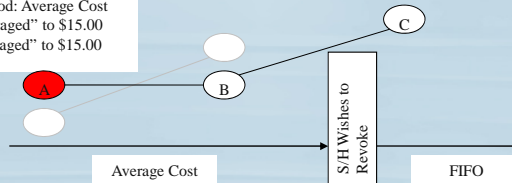


Which lot gets depleted?

Revocations

Revocation: Fund default is average cost; shareholder wishes to revoke

Fund default method: Average Cost
 A: Purchase "averaged" to \$15.00
 B: Purchase "averaged" to \$15.00
 C: Redemption



Which lot gets depleted?

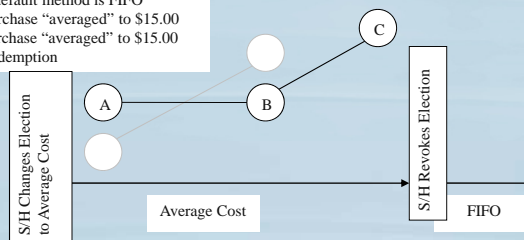
Solution: Fund depletes the purchase A, at the average price cost.

- (Shareholders may ONLY revoke an average cost election they have made, not the fund's default method.)
- If fund selects average cost as the default method, shareholders that acquire shares under that default method are "locked in" to average cost for those shares.

Revocations

Revocation: Shareholder revokes an average cost election after the redemption

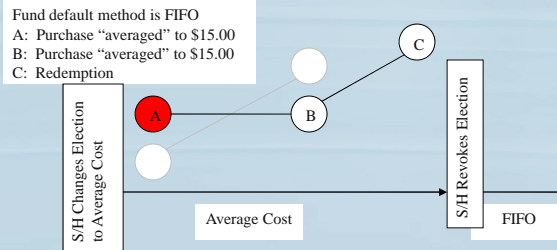
Fund default method is FIFO
 A: Purchase "averaged" to \$15.00
 B: Purchase "averaged" to \$15.00
 C: Redemption



Which lot gets depleted?

Revocations

Revocation: Shareholder revokes an average cost election after the redemption



Which lot gets depleted?

Solution: Fund depletes lot A, at the average cost price, but will apply the FIFO election to future purchases (the shareholder submitted revocation instruction too late).

Other Open Issues

Other Open Issues

- Choice of Default Method
 - It is unclear whether brokers may choose a method other than FIFO or average cost for mutual fund shares.
- February 15 Reporting Deadline
 - Final regulations may preclude IRA custodians from consolidating tax information with taxable accounts.
- In-kind Distributions from IRAs
 - Final regulations require the IRA custodian to send a transfer statement indicating that the shares are noncovered.

Other Open Issues

- Gifted Securities
 - Although donees typically take on the holding period of the donor, the holding period may restart on the date of gift 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.

Operational Challenges

Operational Challenges - Single Account Average Cost

- Making the single account election
 - When is information “accurate?”
 - What does notification mean?
- Ongoing regulatory uncertainty
 - Will IRS modify single account election rules?

Operational Challenges - Specific ID, Standing Orders and Lot Depletion

- How are lots without cost basis information depleted under a standing order?
- How do wash sale adjustments to cost basis and holding period impact application of standing orders?
- Does trading authority for an account not subject to average cost permit the investment advisor to pick lots to be sold or transferred?

CBR Methodologies - Special Considerations for Average Cost

Questions ???

Cost Basis Reporting Workshop

MARCH 31, 2011
IRVINE, CA

Changes of Ownership

Jeff Naylor, Moderator
SunGard–Asset Arena

Jeff Cook
DST Systems, Inc.

Deanna Flores
KPMG LLP

Allison Myers
Fidelity Investments

Agenda

- Overview
- Inherited Shares
- Gifted Shares
- Interplay of Inherited and Gifted
- Divorce
- Q&A - Roundtable

Overview

- Panel Scope
- For each item
 - What are the basic rules?
 - What are the operational considerations?
 - Example(s)

Inherited Shares

- Inherited = transferred from a decedent or decedent's estate
- Generally, transfer statement must
 - Flag security as inherited
 - Report DoD as original acquisition date
 - Report basis as FMV on DoD
 - Instructions / valuations from authorized representative of the estate supercede: must accept
- If FMV on DoD unknown
 - Must flag as inherited
 - May (not must) otherwise report as noncovered
 - Generally irrelevant for RIC shares, but
 - May apply to shares acquired after DoD

Inherited Shares

- Joint accounts: shares that cannot be identified as transferred from the decedent
 - Must treat as noncovered
 - Prohibited from flagging as inherited
- Subsequent transfers
 - Must flag as inherited if prior transfer statement did
 - Security does not become "un-inherited" until sold
 - Cash legacy
 - Not inherited; regular transfer statement rules apply

Inherited Shares

- Operational considerations
 - How to identify cash legacy shares
 - Which transfer types fall into the “can’t tell” rule?
 - Tenants In Common?
 - Joint Tenants With Rights Of Survivorship?
 - Tenants by Entirety?
 - Community property
 - From Publication 564, “If one spouse dies and at least half of the community interest is includable in the decedent’s gross estate, the FMV of the community property at the date of death becomes the basis of both halves of the property.”

Inherited Shares

- Operational considerations (cont’d)
 - Shares acquired *after* DoD
 - Noncovered?
 - If no estate, can there be an “authorized representative?”
 - “Sort of” inherited
 - Partnerships / associations
 - Trusts
 - Grantor trust: disregard
 - “Real trust”

Inherited Shares

Example

- Joe Smith passes away. He is survived by his wife, daughter, and two partners from XYZ Real Estate partnership (legal and tax partnership). Accounts over which Joe was authorized to conduct business include:
 - Personal account in his name only; pursuant to will, the assets in account are divided up among nieces and nephews pro rata (no cash legacy)
 - JTWROS account with Mrs. Smith
 - Grantor trust for which he was trustee and his daughter is named as beneficiary
 - Non-grantor trust with its own EIN benefitting Joe's niece, for which Joe is trustee (but was not the grantor)
 - Partnership account

Inherited Shares

- Distribution of assets (assuming no instructions from authorized rep and no indication that shares are in satisfaction of cash legacy)
 - Personal account
 - Marked as inherited, stepped up to FMV on DoD
 - JTWROS
 - Shares re-registered to wife.
 - Lots split in half, basis stepped up to FMV on DoD on one-half?
 - Aggregate FMV split in half, and basis adjustment spread across all lots pro rata?
 - Grantor trust
 - Inherited by daughter. Marked up to FMV on DoD
 - Trust for nieces and nephews
 - If transfer or re-registration triggered by Joe's death, no inheritance, treat as regular transfer
 - Partnership
 - Transfers of assets out of partnership account are not transfer from a decedent or estate; regular transfer


Gifted Shares – Basic Rules

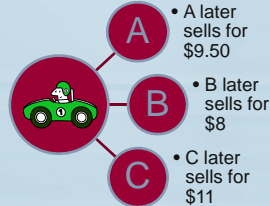
- Gift (or deemed gift) rules apply to transfers, other than inheritances, that affect ownership changes of shares
 - Account re-registrations default to gift status absent other information regarding the reason for the transfer
- Donees typically take the holding period of the donor and carryover basis from the donor
 - Holding period and adjusted cost basis exceptions apply to shares gifted at a loss (see Example 1)
- Transfer statement must include:
 - Donor's basis and FMV of shares on date of gift, even if shares gifted at a gain
 - Receiving broker must maintain both numbers, as donee's basis may depend on FMV upon a subsequent sale

Transfers Excepted from Gift Reporting Requirements

- Transfers between persons where gift basis adjustments are not applicable
 - Transfers between spouses, including transfers incident to divorce
- Transfers between accounts that share at least one common owner
- Transfers of noncovered securities

Gifted Shares – Example 1

Donor  gifts mutual fund shares on 1/15/15 to A, B, C when adjusted basis is \$10 and original acquisition date is 6/21/12. At date of gift, fair market value of shares is \$9.



- Which donee recognizes no gain or loss?
- Which donee recognizes gain?
- Which donee recognizes loss?
- Which donee “tacks” the donor’s holding period?
- Which donee can use average cost?

Gifted Shares – Example 2



A

A re-registers Fund shares in her individual account to a joint account for herself and B. Is this a transfer subject to gift reporting if:
 A acquired shares after 2012?
 A and B are spouses?
 A and B are otherwise related?
 A and B are unrelated?



A



B

Blended Gifted/Inherited Shares Issues

- Shares Gifted to a Decedent
 - Special rules apply to shares you gifted and within 1 year you inherit those shares back from the decedent. If the shares were appreciated property on the date of the gift, the basis of the inherited shares is the decedent's basis in them instead of the FMV.
- Inherited Securities then Gifted
 - Final regulations do require that inherited shares later gifted or transferred must still indicate the shares were inherited. The FMV or alternate valuation and holding period passes to the donee.
 - There is one open issue with regard to the holding period of shares gifted at a loss and then sold at a loss.

Divorce Shares Issues

- Spousal Transfers and Transfers due to Divorce are ***not*** gifts under cost basis considerations.
- Operationally, the third-party instruction provisions of final regulations would cover the receipt of divorce decree as instructions for share transfer.
- Dispensation of shares would typically be handled in one of three ways:
 - Pro-rated
 - Specific Lot Division
 - One Spouse Gets All

Divorce Shares Issues

- Pro-rated
 - If a divorce decree splits an account into two equal parts (such as a 50/50 or 60/40 split), each tax lot (basis and hold period) can be divided and transferred into new individual accounts on the pro-rated basis.
- Specific Lot Division
 - If a divorce decree specifies which party is to receive certain lots, transfers of the specified lots (basis and hold period) can be made into each new individual account.
- One Spouse Gets All
 - If a divorce decree specifies one party is to receive all lots, a transfer of all lots (basis and hold period) can be made into a new individual account.

Changes of Ownership

Questions ???

Cost Basis Reporting Workshop

MARCH 31, 2011
IRVINE, CA

Ready, Set, Go! Preparing to Service Shareholders

Charles Hawkins, Moderator
BNY Mellon Asset Servicing

Nino Palermo
American Funds

Diane Butler
Investment Company Institute

Laura Stanley
Invesco

Allison Myers
Fidelity Investments

Question 1

How do funds intend to communicate to shareholders their default basis reporting method?

- A. All written communication (e.g., Prospectus, new account application, statements, confirms, etc.) AND a stand-alone mailing
- B. All written communication BUT NOT a stand-alone mailing
- C. Prospectus, new account application AND a stand-alone mailing
- D. Prospectus and new account application only

Question 1

How do funds intend to communicate to shareholders their default basis reporting method?

- A. 4 points
- B. 3 points
- C. 2 points
- D. 1 point

Choosing The Fund's Default Method

Nino Palermo
American Funds

Choosing the Fund's Default Method

Polling Question:

What default basis method is your firm planning to use?

- a. Bifurcated Average Cost
- b. FIFO
- c. Formulaic Method
- d. Other
- e. Undecided

Choosing the Fund's Default Method

Choosing a Default: Single Account Average Cost

Why

- Most consistent if currently providing average cost and believe the vast majority of investors are using it
- Easiest to train/communicate
- Beneficial to IRS because noncovered shares become covered
- Systematically less complicated

Why Not

- **NOT AN OPTION** given average cost affirmative consent provision
- Question #55 – Has investor been using average cost
- Difficult to “Opt Out” both from an investor and system point of view
- Makes current noncovered shares covered and, as such, reportable

Choosing the Fund's Default Method

Choosing a Default: Bifurcated Average Cost

Why

- Currently providing average cost
- Belief that the vast majority (90% or greater) of your investors are using average cost
- Easier to train/communicate because it most closely aligns with your current practice
- Offers some investor choice where covered/noncovered are concerned
- Does not require an affirmative election

Why Not

- Prospective “Opt Out” provisions
- Least tax efficient
- Possible transfer considerations
- Affirmative consent to switch
- Could result in some investor confusion given 2 average cost numbers

Choosing the Fund's Default Method

Choosing a Default: FIFO

Why

- May not be providing basis information currently or believe many investors are not using average cost
- Most easily communicated/understood
- Same default as stocks
- Offers some investor choice where covered/noncovered are concerned

Why Not

- Forces an affirmative average cost election from investor
- Potential 1099B reporting issues for investors who purchase systematically and reinvest dividends
- Possible investor confusion if average cost has been provided for noncovered shares

Choosing the Fund's Default Method

Choosing a Default: Formulaic Method

Why

- May not be providing basis information currently or believe many investors are not using average cost
- Many HNW investors
- Potentially offers the most tax-advantageous method
- Offers greatest investor flexibility depending on offering

Why Not

- Questionable as an option
- Forces an affirmative average cost election from investor
- Could result in investor confusion if both covered and noncovered shares exist
- Difficult to train/communicate
- Potential 1099B reporting issues for investors who purchase systematically and reinvest dividends

Choosing the Fund's Default Method

Choosing a Default: Things to Consider

- What is in the best interests of the majority of shareholders?
- What can most easily be communicated and understood?
- What offers the shareholder the most flexibility?
- What part(s) of the regulations make each choice the most/least practical?
- What are other reporting brokers offering to their investors?

Question 2

A fund intends to use the single account election for a shareholder that has elected to use average cost, but is missing some information about certain pre-effective date share lots. What should the fund do?

- A. Call the shareholder and ask for the missing information
- B. Contact the shareholder and request that the shareholder provide the information in writing
- C. Don't contact the shareholder and default to bifurcated average cost

Question 2

A fund intends to use the single account election for a shareholder that has elected to use average cost, but is missing some information about certain pre-effective date share lots. What should the fund do?

- A. 1 point
- B. 4 points
- C. 4 points

The Single Account Election:

Great in Theory...Does It Work?

Allison Myers
Fidelity Investments

Single-Account Election: Big Picture

- General rule: Covered and noncovered shares in an average cost (AC) position must be treated as held in separate accounts
 - Two ACs: AC per covered share, AC per non-covered share
- Exception: RIC or broker makes a “single-account election”
 - A single average cost per share: one bucket
 - All shares in the single account are covered

Single-Account Election: Big Picture

- Pros
 - Comfortable for shareholders – nothing changes on surface
 - Redemption orders do not need to distinguish which account or deemed account to deplete
- Cons
 - Legal risk
 - Complex to implement
 - Complex disclosure / servicing issues
 - Turns noncovered into covered
 - RIC/broker cannot revoke

Single Account Election: Pre-Requisites

- Stock must be subject to *shareholder's* average cost election -- if no average cost election on file, no single-account election
- Only stock in accounts with same ownership
 - For example, husband's account cannot be single account with h & w joint account

Single-Account Election: Pre-Requisites (cont'd)

- Only good for shares with accurate basis information
 - Accurate if RIC/broker "neither knows nor has reason to know that the basis information is inaccurate"
 - Cross-reference to reasonable cause penalties
 - Risk analysis
 - Customer-provided?
 - Data integrity?
 - past migrations, systems upgrades
 - QC under pre-regulatory P&Ps

Single-Account Election: Making the Election

- Directly held shares = fund makes election
- Brokerage held shares = broker makes election
- No IRS filing required
 - Just own books and records
 - Name, account number, TIN, which stock subject to election, taxpayer's basis
 - Must provide copies upon request
- Can make at any time
- Shareholder notification
 - "Reasonable means"
 - Identify securities and advise that all shares now covered

Single-Account Election: Post-Election

- Single-account election void if customer revokes average cost election
 - Must keep all individual lot history while average cost revocation period is open
- Later-acquired stock
 - If stock with unknown/inaccurate basis later comes into the account, must treat as separate account
- Later-acquired info
 - Still bifurcated unless new election is made

Question 3

How proactive should a fund be in soliciting customer cost basis elections other than the fund's default method?

- A. Very proactive, the fund should try to get an election from every shareholder, even if it means sending requests out multiple times
- B. Proactive, the fund should send information to shareholders explaining the fund's default method, what other methods are available and describing each alternate method
- C. Passive, the fund should provide the information upon request, but shouldn't incur the expense of sending material out to all shareholders

Question 3

How proactive should a fund be in soliciting customer cost basis elections other than the fund's default method?

- A. 2 points
- B. 4 points
- C. 1 point

Customer Elections for Cost Basis Reporting

Diane Butler
Investment Company Institute

Final Regulations: What Do They Say About Customer Elections?

- Final CBR Regulations provide flexibility to taxpayers
 - Taxpayers may select specific identification or average cost for fund shares
 - Taxpayers may change basis methods at any time during the tax year
 - Taxpayers may select a method on a sale by sale basis
- Funds and brokers must be prepared to support this flexibility

Final Regulations – What’s Different When Selecting Average Cost?

- Shareholder must make average cost elections in writing
- Shareholder revocations of average cost must be provided in writing
- Notification of change from average cost must be provided in writing
 - The in writing requirement applies even if the shareholder was defaulted into average cost by the fund
- What is in writing?
 - “By any reasonable means”
 - Electronic writing is okay – What does that mean to your organization?

Fund Policies for Customer Elections

- Funds are required to support specific identification and average cost
- Funds are not required to take standing instructions
 - Which will your organization support – FIFO, HIFO, LIFO, etc.?
- Systematic withdrawals and automatic exchanges
 - How will these be handled with a true specific ID election?
- Non-shareholder-generated redemptions for account charges
 - 1099-B reportable events
 - How will account charges be handled post CBR?
 - Will these end the revocation period for average cost?
 - Will you allow shareholders to pre-pay fees?
- Will you voluntarily provide cost basis on noncovered shares?
- What policy will funds adopt for depletion of noncovered shares?

Communicating With Shareholders About Customer Elections

- Explain the impact of the CBR regulations to shareholders
- Describe the fund policies for cost basis reporting
 - Default method, standing orders, noncovered shares, etc.
- Provide instructions to shareholders for making cost basis choices
 - Selecting a cost basis method
 - Changing cost basis methods
 - Revoking an average cost election
 - Selecting lots when requesting a redemption
- How do you communicate complex ideas to shareholders?
 - Gifted/inherited shares
 - Corrections
- When and how often do you communicate to shareholders?

Preparing Employees to Manage the Customer Election Process

- Employee training on cost basis reporting
 - Service center education on fund policies for customer elections
- Phone scripts and other employee resources
- Changes to forms for shareholders
 - New account application
- Shareholder service or tax advice?
 - Teaching employees to draw the line
- All service staff or dedicated cost basis team?

Question 4

When should a fund conduct its initial S Corp solicitation?

- A. Should have already started
- B. 2nd Quarter 2011
- C. 3rd Quarter 2011
- D. 4th Quarter 2011

Question 4

When should a fund conduct its initial S Corp solicitation?

- A. 2 points
- B. 2 points
- C. 4 points
- D. 3 points

The New W-9: More than a Form Update

Allison Myers
Fidelity Investments

New W-9: Overview

- S Corps are no longer exempt recipients!
 - for gross proceeds on covered securities acquired on or after 1/1/2012
 - “covered S” proceeds
- Eyeball test is gone (mostly)
- Backup withholding will apply to corporate accounts missing a certified TIN

New W-9: Statutes and Regs

- Section 6045(g)(4)
 - IRS must treat S Corps as partnerships for purposes of Section 6045 (but only for covered S proceeds)
- IRS implementation
 - S Corporations removed from list of exempt recipients with respect to covered S proceeds
 - New W-9 shows S Corp vs. C Corp status
 - Substitute W-9s need to reflect
 - Eyeball test for covered S proceeds limited to
 - Insurance companies, per se corp under 7701 regs, W-8 shows foreign corp status

New W-9: Broker/Fund Requirements

- Backup withholding starts on 1/1/2012 for covered S proceeds
 - Corporate accounts without certified TINs cannot be treated as exempt (unless limited eyeball test applies)
 - Re-certification required to avoid
 - No grandfathering available
 - Can your backup withholding system distinguish between S covered and noncovered proceeds?

W-9
Form (Rev. January 2011)
Department of the Treasury
Internal Revenue Service

Request for Taxpayer Identification Number and Certification

Give Form to the requester. Do not send to the IRS.

Name tax shown on your income tax return

Business name/disregarded entity name, if different from above

Check appropriate box for federal tax classification (required): Individual/sole proprietor C Corporation S Corporation Partnership Trust/estate Exempt payee

Limited liability company. Enter the tax classification (LLC, S corporation, SdS corporation, Partnership) Other (see instructions)

Address number, street, and apt. or suite no. Requester's name and address (optional)

City, state, and ZIP code

List account number(s) here (optional)

Part I Taxpayer Identification Number (TIN)

Enter your TIN in the appropriate box. The TIN provided must match the name given on the "Name" line to avoid backup withholding. For individuals, this is your social security number (SSN). However, for a resident alien, sole proprietor, or disregarded entity, see the Part I instructions on page 3. For other entities, it is your employer identification number (EIN). If you do not have a number, see *How to get a TIN* on page 3.

Social security number

Employer identification number

Part II Certification

Under penalties of perjury, I certify that:

- The number shown on this form is my correct taxpayer identification number (or I am waiting for a number to be issued to me), and
- I am not subject to backup withholding because: (a) I am exempt from backup withholding, or (b) I have not been notified by the Internal Revenue Service (IRS) that I am subject to backup withholding as a result of a failure to report all interest or dividends, or (c) the IRS has notified me that I am no longer subject to backup withholding, and
- I am a U.S. citizen or other U.S. person (defined below).

Certification instructions. You must cross out item 2 above if you have been notified by the IRS that you are currently subject to backup withholding because you have failed to report all interest and dividends on your tax return. For real estate transactions, item 2 does not apply. For mortgage interest paid, acquisition or abandonment of secured property, cancellation of debt, contributions to an individual retirement arrangement (IRA), and generally, payments other than interest and dividends, you are not required to sign the certification, but you must provide your correct TIN. See the instructions on page 4.

Sign Here Signature of U.S. person Date

Question 5

A shareholder sends a letter to a fund to correct an error in the lot history of his/her account. The fund should:

- A. Make the correction, because the instruction was in writing
- B. Make the correction, but take steps to make sure that the information provided by the shareholder is reasonable
- C. Make the correction, but only after the shareholder's account history has been reviewed and the fund confirms that it has made a mistake

Question 5

A shareholder sends a letter to a fund to correct an error in the lot history of his/her account. The fund should:

- A.** 1 point
- B.** 4 points
- C.** 3 points

Corrections & Penalties

Laura Stanley
Invesco AIM

Corrections

Corrected reporting is required...

...whenever an issuer determines additional facts that result in a different quantitative effect on basis from what the issuer previously reported.

...only when brokers receive corrected information within 3 years after issuing a Form 1099-B or 18 months after issuing a transfer statement.

.....when an organizational action affects the basis of a security.

Corrections

Examples:

- Processing Errors
- Incomplete Data
- Revocations
- Return of Capital

➤ Corrective actions should cover revised reporting - issuer and transfer statements

Information Reporting Penalties

- The Small Business Jobs Act of 2010 increased penalties for failures to file or for providing incorrect or incomplete information on Forms 1099-B, transfer statements, and issuer statements, among others.
 - Filings with the IRS: Maximum \$100 per form up to \$1.5M per reporting entity.
 - Payee and Transfer Statements: Maximum \$100 per form up to \$1.5M per reporting entity.
 - New total maximum per reporting entity = \$3M.
- Reduced penalties for small businesses (gross receipts < \$5M).
 - Maximum penalty reduced to \$1M total.

Questions and Answers



Cost Basis Reporting Workshop

MARCH 31, 2011
IRVINE, CA

Making a Pass—Transfers Resulting from a Change in Reporting Broker

Nino Palermo, Moderator
American Funds

Lydia Midwood
Depository Trust & Clearing
Corporation

Jeff Naylor
SunGard—Asset Arena

Laura Stanley
Invesco

Derek Yen
Edward Jones

Making a Pass: Transfers Resulting from a Change of Reporting Broker

- Passing On the Cost: Reporting Broker Requirements
- Beating the Heat with “CBRS”
(pronounced sea-breeze)
- The Dreaded “Others”...

Making a Pass: Transfers Resulting from a Change of Reporting Broker

- Reporting Broker Requirements
 - **Furnishing the Information**
 - Every applicable person which transfers to a broker (as defined in section 6045 (c)(1)) a security which is a covered security (as defined in section 6045 (g)(3)) in the hands of such applicable person shall furnish to such broker a written statement in such manner and setting forth such information as the Secretary may by regulations prescribe for purposes of enabling such broker to meet the requirements of section 6045 (g).
 - **Applicable Person**
 - For purposes of subsection (a), the term “applicable person” means ---
 1. any broker (as defined in section 6045 (c)(1)), and
 2. any other person as provided by the Secretary in regulations.
 - **Time for Furnishing Statement**
 - Except as otherwise provided by the Secretary, any statement required by subsection (a) shall be furnished not later than 15 days after the date of the transfer described in such subsection.

Making a Pass: Transfers Resulting from a Change of Reporting Broker

- **Cost Basis Reporting Service (“CBRS”)**
 - **Overview**
 - The Cost Basis Reporting Service (CBRS) is an automated system that gives financial firms the ability to transfer customer cost basis information from one firm to another on any asset transfer. The system provides a centralized communications hub that mitigates risk, promotes standardization and helps customers meet their regulatory requirements in an efficient and cost-effective manner.
 - **Who Can Use It**
 - All financial intermediaries subject to the IRS regulations are eligible to apply to use CBRS, including firms who are not currently members of any service offered by one of DTCC’s affiliate companies.
 - **Benefits**
 - Provides the industry with a secure and automated standard for passing cost basis information when assets or customer accounts transfer between financial intermediaries.
 - Assists financial organizations with complying with cost basis legislation
 - Extends the efficiencies and capabilities of the previous CBRS system, used by broker-dealers and banks, to new parties, such as transfer agents, issuers, and mutual fund companies.

Making a Pass: Transfers Resulting from a Change of Reporting Broker

- **Cost Basis Reporting Service (“CBRS”)**
 - **How it Works**
 - After a firm transfers an asset to a counterparty, it can use CBRS to send the asset’s cost basis information to that counterparty. The service also allows a firm to send corrected cost basis information (if necessary), request cost basis if it has not received it, or reject cost basis it feels is not correct.
 - **Features**
 - CBRS has two input record types: Asset records and Tax Lot records. A firm submits an Asset record for each asset for which it needs to pass cost basis information. The Asset record must have at least one, but can have an unlimited number of, associated Tax Lot records. Tax Lot records contain detailed cost basis information for each Asset record.
 - Cost basis information can be supplied for any asset transfer, even transactions that occur outside of DTCC’s affiliate companies.
 - The records include data elements relevant to the IRS regulations, such as information about gifted or inherited shares.
 - **More Information**
 - Please contact DTCC Relationship Services at 800-422-0582.
 - <http://www.dtcc.com/products/documentation/cs/cbrs.php>

Making a Pass: Transfers Resulting from a Change of Reporting Broker

- Using CBRS
 - BDAC Task Force
 - Getting Started
 - “Best Practice” Guidelines
 - Non-ACATS and Networking Transfers
 - Lot Depletion
 - Partial Transfers
 - Noncovered Shares
 - Corrections/Corporate Action Events
 - 2011: Broker/Dealer Experience
 - Quality and Quantity
 - Timing
 - The Need to Test!
 - Contact Information
 - 2012 and Beyond: Considerations/Things to Think About

Making a Pass: Transfers Resulting from a Change of Reporting Broker

- Non-CBRS Transfers
 - Things to Think About
 - Policies/Procedures
 - Contact Information
 - Timing/Follow Up

Advanced Issues Roundtable

Karen Gibian, *Moderator*
Investment Company Institute

Advanced Issues

- Returns of Capital
- Transfers of Like Registrations
- Wash Sales
- Shareholder-Provided Information
- Sales Load Basis Deferral Rule
- Class B to Class A Conversions

Returns of Capital

- RIC Modernization Act of 2010
 - 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.

Returns of Capital

- Issuer Reporting – New Section 6045B
 - Quantitative effect of action
 - Report provided within 45 days of action
 - Receiving broker must correct Forms 1099-B, transfer statements
 - Effective for corporate actions affecting all RIC shares beginning in 2012
- Corrections
 - Forms 1099-B – 3 years
 - Transfer Statements – 18 months

Returns of Capital

- How do returns of capital impact transfer reporting?
 - If the shares subsequently have been transferred to another broker, who is responsible for making the return of capital adjustment?
 - Why can't the receiving broker make the necessary adjustments?
 - What happens if the information is received after the 18-month correction period?

Transfer of Like Registrations: Impact of Average Cost Elections

- The revocation period for a shareholder's average cost election ends upon a "sale, transfer or other disposition."
 - What constitutes a "transfer" for this purpose?
 - Final Regulations do not differentiate between types of transfers
 - Change of Ownership vs. Change of Reporting Broker
 - Transfer reporting statement required for both

Transfer of Like Registrations: Impact of Average Cost Elections

- How is a transfer of a like registration impacted by an average cost election?
 - If the revocation period has not ended, what information is transferred to the new account?
 - Average Cost
 - Individual Lot History
- How is a transfer of a like registration impacted by a single account election?
 - If the shareholder's revocation period has not ended, what information is transferred to the new account?
 - Average Cost; all treated as covered shares
 - Individual lot history; covered and noncovered shares

Wash Sales

- A broker must apply the wash sale rules if both the sale and purchase transactions are of covered securities with the same CUSIP.
 - Must report the amount of loss disallowed due to the wash sale on Form 1099-B and increase adjusted basis of purchased security by amount of loss disallowed.
- A broker is **NOT** required to apply these rules if:
 - The securities are purchased and sold from different accounts.
 - The purchased security is transferred to another account before the wash sale.
 - The securities are treated as held in separate accounts (covered and non-covered).
- Shareholders still are responsible for applying these rules across accounts.

Wash Sales

- Determination of holding period adjustment for acquired stock triggering wash sale
 - Two possible approaches -- “holding period” or “replacement date”
 - Ex. 1: Buy Lot A 1/10/2011; Sell Lot A 1/15/2011; Buy Lot B 1/20/2011
 - Add 5 days to holding period or set adjusted holding date to 1/10/2011 for Lot B?
 - Ex. 2: Buy Lot A 1/10/2011; Buy Lot B 1/15/2011; Sell Lot A 1/20/2011
 - Add 10 days to holding period or set adjusted holding date to 1/10/2011 for Lot B?
- No tracking by brokers of wash sales in nontaxable accounts
 - But, potential customer wash sale obligations with respect to sales and purchases of substantially identical securities in taxable and nontaxable accounts (Rev. Rul. 2008-5)
- No revised Schedule D yet for customer reconciliation of 1099-B reporting and “actual” wash sales across accounts

Shareholder-Provided Information

- Brokers are permitted, but not required, to take into account information provided by the shareholder when calculating basis.
- A broker is deemed to have relied upon shareholder-provided information in good faith if the broker *neither knows nor has reason to know* that the information is inaccurate.

Shareholder-Provided Information

- In what situations will brokers and funds accept shareholder-provided information?
 - Covered shares
 - Single Account Election
- When does a broker “neither know nor have reason to know” that the information is inaccurate?

Sales Load Basis Deferral Rule

- RIC Modernization Act of 2010
 - 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.
- Shareholder redeems Fund A and reinvests in Fund B – Broker is **NOT** required to apply sales load basis deferral rule because the transaction occurs across two accounts.
- Shareholder redeems Fund A and then reinvests in Fund A – Broker must adjust basis if reinvestment right is exercised by January 31 of year following year of redemption.

Class B to A Conversions

- Conversions of Class B shares to Class A shares are not an event for tax purposes.
 - Outside of cost basis reporting, IRS treats all shares within a fund as identical securities.
- No basis reporting is required upon a B to A conversion.
- The basis of the Class B shares is allocated to the Class A shares.

Class B to A Conversions

- Issues to consider:
 - Shareholder may have different basis calculation methods on each account
 - Transferred tax lots should move FIFO
 - Tax lot aging should carry over

ICI Cost Basis Reporting Workshop

Questions ???

Continuing Professional Education (CPE) Credit

If you wish to receive CPE credit, please
contact Judy Lee in ICI's Continuing
Education Department

Email jlee@ici.org

or

Call (202) 218-3575

ICI Cost Basis Reporting Member Resource Page

- Available to all ICI members and committee members at:
 - http://www.ici.org/policy/tax/cost_basis_reporting