



What are the latest cost basis reporting requirements?

- Congress passed the Emergency Economic Stabilization Act on October 3, 2008, which requires firms like yours to report adjusted cost basis for taxable accounts to the IRS via Form 1099-B beginning in 2011. The final ruling was issued by the IRS on October 12, 2010. You can gain access to the final regulation, as well as other helpful information, under the “Cost Basis Reporting on Securities Sales” section located via the following link:

<http://www.irs.gov/taxpros/article/0,,id=225080,00.html>

What are some other important considerations regarding the rule changes?

- Penson Cost Basis System will account for the rules regarding cost accounting:
 - Gifts
 - Inheritances
 - Wash sales
 - Short sales
 - Corporate Actions
- Cost basis is the original purchase price you paid for an investment. Adjusted cost basis is the original cost basis and any adjustments due to wash sales, corporate actions, and any other transactions that affect cost basis.

When will the various phases take affect and what is covered?

Covered under the legislation:

- Equities purchased or acquired on or after January 1, 2011
- Mutual funds, DRIPs and all other Registered Investment Companies purchased or acquired on or after January 1, 2012
- Options, Bonds, and all other securities purchased or acquired on or after January 1, 2013

Will your client’s responsibility for filing capital gains and losses on a Schedule D change?

- No, taxpayers will still be responsible for reporting capital gains and losses on Schedule D based on an aggregate view of all holdings across all of their accounts that have the same social security number or tax ID.
- If clients have more detailed questions about their personal tax reporting, please direct them to their tax advisor for assistance.

How is a tax lot defined?

- A tax lot is a grouping of a security that has the same price and trade date. In most cases, a trade represents a tax lot.
- As lots are sold or short sell lots are covered, the system will break up the lots if the amount of shares being sold or covered does not equal the existing lots they are matching to.
 - For example: A client owns 300 share lot of an equity. The client sells 200 shares of that equity. The 300 share lot will be broken into a 200 share lot, which will be matched based on the client’s instructions or the default of FIFO, and a 100 share lot will continue to show as open for the account.

What is wash sale and what are its components?

- The wash sale rule only applies to transactions for the exact same CUSIP.
- A transaction to sell or buy-to-cover is identified as a wash sale if the replacement shares are bought or sold short within 30 days before or after the sell or buy-to-cover. The wash sale loss is added to the basis of the replacement shares.
- Replacement shares are created by the buy or short-sell transaction that occurs within 30 days before or 30 days after a sell or buy-to-cover transaction that had resulted in a realized loss.
- Disallowed loss is the amount of the realized loss from the sell or buy-to-cover that is applied to the replacement buy or short-sell transaction.
- The basis adjustment is important as it preserves the benefit of the disallowed loss. You'll receive that benefit on a future sell of the replacement stock.
- The sale of a replacement shares can result in a wash sale. The same window of 30 days before and 30 days after applies to the replacement shares.
- The amount of the wash sale shares are equal to the amount of the replacement shares that were purchased or sold short. So, only that share amount will have a disallowed loss applied to them.
 - Example – Wash Sale: If the client sells 200 shares at a loss but has bought the same CUSIP within 30 days before or 30 days after the sell, then the sell is a wash sale. If the buy was for 100 shares, only the loss on 100 of the 200 share sell is disallowed and applied to the replacement shares. The client is allowed a loss on the other 100 shares.
 - Example – Wash Sale/Short Sell: If the client has a buy-to-cover 200 shares at a loss but has a short sell of the same CUSIP within 30 days before or 30 days after the buy-to-cover, then the buy-to-cover is subject to wash sale. If the short sell was for 100 shares, only the loss on 100 of the 200 share buy-to-cover is disallowed and applied to the replacement shares. The client is allowed a loss on the other 100 shares.

What are some important considerations you, the correspondent, should have as the cost basis requirements are implemented?

- Evaluate all your current reporting to clients that contain cost basis information.
- Determine if it is relevant information and if you should continue providing that information to your clients.
- If you are using a portfolio management system or any other reporting systems that calculate cost basis and gain/loss on securities transactions, identify the discrepancies that may exist between what they report, and what Penson will be reporting.
- There will be discrepancies between Penson cost basis calculation and your firm's portfolio management systems thanks to the ambiguity with the handling of wash sales, corporate actions and the use of different tax lot relief methods. Please inform your clients to use the data they know to be accurate for the creation of their Schedule D. Many times, the reporting system will have more accurate information than the custodian records.
- Penson suggests you should communicate the details of the Cost Basis Regulation to your clients over the course of 2012. This will minimize client confusion when they receive their Form 1099-B forms starting February 2012.

What is the deadline for reporting cost basis to clients?

- 1099-B forms will be provided on February 15, 2012. If an extension to that date is obtained by Penson, Penson will communicate that.
- The taxpayer filing deadline has NOT changed.
- If an adjustment to basis is made after the reporting deadline to transactions already reported on the 1099-B, Penson will issue an adjusted 1099-B to the client.