

MEMO# 22506

May 13, 2008

House-Passed Housing Bill Includes Cost Basis Reporting

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TO: BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 15-08
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OPERATIONS MEMBERS No. 6-08
SMALL FUNDS MEMBERS No. 31-08
TAX MEMBERS No. 16-08
TRANSFER AGENT ADVISORY COMMITTEE No. 26-08 RE: HOUSE-PASSED HOUSING BILL
INCLUDES COST BASIS REPORTING

Housing legislation (H.R. 3221) that passed the House of Representatives last week includes a provision (section 641 of the bill) that would require brokers (including mutual funds) to report cost basis information to shareholders and the Internal Revenue Service ("IRS"). [\[1\]](#)

The bill would amend Internal Revenue Code ("Code") section 6045 to require brokers, including mutual funds, to report to customers and the IRS the customers' cost basis in securities (including mutual fund shares) sold or redeemed. Brokers also would be required to report the long-term or short-term nature of any gain or loss.

A few important changes urged by ICI and others, and discussed in greater detail below, are included in the bill. First, the cost basis reporting provisions generally would apply to fund shares one year after they applied to other stocks. Second, the reporting deadline for sending year-end tax information to customers generally would be extended from January

31 to February 15.

The bill would apply to shares in all regulated investment companies (“RICs”) -- both mutual funds and closed-end funds -- acquired on or after January 1, 2011; [2] as urged by the ICI and others, this effective date is one year later than the January 1, 2010 date that would apply to other stocks. Unlike earlier-considered cost basis reporting provisions, which would have provided three different reporting regimes for fund shares, [3] the Housing bill’s provision effectively would create two reporting regimes: one for fund shares acquired before January 1, 2011 and one for shares acquired thereafter. Under the bill, fund shareholders would have no obligation to use any cost basis information provided voluntarily for shares acquired through 2010, but generally would be required to use the cost basis information provided for shares acquired thereafter.

In the case of funds, the shareholder’s cost basis of post-effective date shares would be determined “in accordance with the broker’s default method unless the customer notifies the broker that he elects another acceptable method under [Code] section 1012 with respect to the account in which such stock is held.” [4] A fund could determine cost basis for shares acquired after the effective date under average cost, first-in/first-out, or any method (such as highest-in/first-out) that involves identification of specific shares. Shares of “open-end funds” [5] acquired before and after January 1, 2011 would be treated as in different accounts, unless the fund elected to treat all of a customer’s shares as in one account. Thus, for example, a mutual fund could provide cost basis information under (i) the average cost method (for pre-effective-date shares, on which reporting would be voluntary), and (ii) a form of specific identification, such as highest-in/first-out (for post-effective-date shares, on which reporting would be mandatory).

The deadline for sending year-end tax information to customers generally would be extended from January 31 to February 15. Unlike the cost basis reporting provision that passed the House last December, [6] this 15-day-reporting extension would apply to all shares in an account, whether or not the account included a transaction for which cost basis reporting was required. This change would apply to statements required to be furnished to customers after December 31, 2008.

The bill would provide a limited exception from the wash sale rule of Code section 1091. Specifically, the wash sale would apply only if the transactions occurred in the same account with respect to identical securities. Regulatory authority would be provided to apply the rule to other transactions. This provision, like the other cost basis reporting changes (other than the February 15 reporting change), generally would take effect on January 1, 2010.

Reporting to S corporations would be required if the shares were acquired after December 31, 2011. The S-corporation reporting provision also was included in the December 2007 House-passed bill. [7]

The proposal would apply to fund shares acquired after the effective date if the shares were (i) acquired through a transaction in the account or (ii) transferred to such account from another account in which the shares were covered by the basis reporting requirement, but only if the broker received a statement under new Code section 6045A with respect to the transfer.

New Code section 6045A would require brokers who transfer securities to another broker to furnish to the transferee a written statement setting forth such information as prescribed in regulations for purposes of enabling the transferee to meet the basis reporting requirements. The statement would have to be furnished no later than the earlier of 15 days after the date of the transfer or January 15 of the year following the calendar year in which the transfer took place. The bill also would impose a penalty on a transferring broker who fails to furnish the written statement.

Keith Lawson
Senior Counsel - Tax Law

endnotes

[1] See http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3221eah.txt.pdf, pp. 559-575.

[2] Specifically, the January 1, 2011 effective date would apply “in the case of any stock for which an average basis method is permissible under [Internal Revenue Code] section 1012.”

[3] See, e.g., Institute [Memorandum](#) (21952) to Bank, Trust and Recordkeeping Advisory Committee No. 50-07, Broker/Dealer Advisory Committee No. 71-07, Federal Legislation Members No. 11-07, Operations Members No. 25-07, Small Funds Members No. 107-07, Tax Members No. 50-07, and Transfer Agent Advisory Committee No. 80-07, dated November 14, 2007.

[4] For other securities, cost basis would be determined using the first-in/first-out method unless the customer adequately identified the specific shares of stock to be sold.

[5] An “open-end fund” would be defined under the bill as “a [RIC] which is offering for sale or has outstanding any redeemable security of which it is the issuer. Any stock which is traded on an established securities exchange shall not be treated as stock in an open-end fund.”

[6] See, Institute [Memorandum](#) (22022) to Bank, Trust and Recordkeeping Advisory Committee No. 55-07, Broker/Dealer Advisory Committee No. 75-07, Federal Legislation Members No. 13-07, Operations Members No. 28-07, Small Funds Members No. 110-07, Tax Members No. 54-07, and Transfer Agent Advisory Committee No. 88-07, dated December 7,

2007.

[7] See Institute [Memorandum](#) (22022), footnote 6, *supra*.

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