

MEMO# 20113

January 5, 2007

GAO Issues Report on Cost Basis Reporting

[20113]

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TO: OPERATIONS MEMBERS No. 15-06

TAX MEMBERS No. 23-06

BANK, TRUST AND RECORDKEEPING ADVISORY COMMITTEE No. 18-06

BROKER/DEALER ADVISORY COMMITTEE No. 21-06

TRANSFER AGENT ADVISORY COMMITTEE No. 39-06 RE: GAO ISSUES REPORT ON COST BASIS REPORTING

The United States Government Accountability Office (the “GAO”) has issued a report to the Senate Committee on Finance regarding the capital gains tax gap and cost basis reporting. The GAO concludes that requiring brokers to report cost basis for all securities, including mutual fund shares, would improve capital gains tax compliance if the related challenges are addressed.

The GAO estimates that 38 percent of individual taxpayers with securities transactions misreported their capital gains or losses in tax year 2001. [\[1\]](#) Of those taxpayers, approximately one-third over-reported and approximately two-thirds under-reported their capital gains. The GAO concludes that requiring information reporting of adjusted cost basis would increase voluntary compliance because taxpayers would not have to track and compute the adjusted basis of the securities they sold, resulting in greater accuracy and a reduced reporting burden.

The report notes, however, that expanding basis reporting involves a number of implementation issues that would need to be addressed. [\[2\]](#) These challenges include:

- Implementing systems to track and report basis involves monetary costs.
- Brokers may not be able to determine basis for some securities transactions because of complex tax laws.
- Brokers may not know basis for securities purchased through another broker.
- Brokers may not know basis for securities purchased through companies that directly issue stock (e.g., employee stock purchase plans).
- Brokers may not know basis for older securities.
- Brokers that do not know the basis may rely on taxpayers to provide basis information without any verification (e.g., for stocks received as gifts).
- Brokers cannot always obtain timely adjusted basis information from companies that issue stock and engage in corporate events (e.g., mergers, acquisitions).

The GAO suggests ways for mitigating these challenges, including a prospective effective date for any basis-reporting requirement. The report notes that, based on interviews with industry representatives, many brokers and mutual funds already provide basis information to a significant portion of their clients and shareholders. [\[3\]](#)

The GAO also describes challenges that may be faced by the Internal Revenue Service and ways in which to mitigate those issues.

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[Attachment](#)

endnotes

[\[1\]](#) See page 11, Table 1, of the GAO's report. This figure includes the 13 percent of mutual fund shareholders who incorrectly report their capital gain dividends.

[\[2\]](#) See page 27, Table 7, of the GAO's report for a table listing the identified challenges to brokers and ways in which such challenges could be mitigated.

[\[3\]](#) The Institute met with the GAO as they were preparing their report to discuss current practices in the mutual fund industry and issues that would arise if a basis reporting requirement were implemented.