

New Cost Basis Reporting Rules Require New Attention from Investors

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Beginning in 2011, brokers will be required to report the cost basis of securities acquired and sold after January 1, 2011 to the Internal Revenue Service for taxable accounts (not retirement accounts). Up until that date, brokers were required to report only the gross proceeds on sales for taxable accounts. Cost basis is the original purchase price you paid for an investment, plus commissions and fees.

The practical effect of this is that the broker will report a sales transaction in its entirety if it involves a security purchased on or after January 1, 2011. The I.R.S. will match the broker reporting with the reporting on the tax return and will issue a Notice of Proposed Change if the cost basis does not agree. Therefore, it's extremely important to make sure that the amount reported by the broker agrees with the amount reported on your tax return.

Brokers will automatically track any securities they purchase for you. For securities that were not purchased by that broker, you will be required to supply them with cost basis information. For instance, you may have inherited securities or securities that were originally purchased through a different broker. Have the cost basis information available and supply it to your broker as soon as possible so that they have it on file in case of a sale.

SEVERAL METHODS FOR DETERMINING COST BASIS

You should also be aware that there are many different ways of computing cost basis for a particular sale. Most brokers will use a default of first shares purchased, first shares sold (FIFO), if you do not specify a method. However, this may not be the optimal choice. Other choices include:

- LIFO (last shares purchased are the first ones sold)

- High Cost (highest cost shares are sold first)
- Low Cost (lowest cost shares are sold first)
- Specified lot (this allows you to choose specific lots as being sold, usually identified by purchase date).

You will be required to advise your broker if you choose a method other than the default method for a sale. If you trade by the Internet, you will be required to indicate your cost basis method chosen if other than a default method. Different choices will yield different tax results, so care must be taken in choosing a method. Otherwise, you may end up with an unintended tax result.

WHAT YOU SHOULD DO

The new reporting requirements make it critically important for most investors to engage in proactive tax planning.

- Determine which shares do not have an associated cost basis, determine such cost basis and supply this information to your broker.
- Contact your AKM CPA to discuss your investment goals, tax exposure and other financial issues.
- Determine whether it makes sense to issue standing orders on cost basis to your broker or, instead, to determine cost basis on an individual sale basis.
- Make sure that your brokers, agents and other advisors have clear instructions from you on how to determine cost basis.

As always, please call your AKM CPA if you would like more details or to plot your strategy for dealing with these new provisions.

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