

INVESTOR ALERT - THE NEW IRS REPORTING RULES

They affect anyone with a brokerage account.

Provided by Renita M. Owens, CPA, PFS

Are you going to purchase stocks in 2011? If your answer to that question is “yes”, there’s an important IRS rule change you should know about.

If you buy a stock in 2011, your broker must report the gain or loss when you sell it. In fact, this will be true for the following investment classes as of the following dates:

- Individual stocks you buy after January 1, 2011
- Mutual fund shares you buy after January 1, 2012
- Bonds, options & other securities you buy after January 1, 2013^{1,2}

Prior to 2011, reporting the gain or loss triggered by the sale of an investment was your responsibility - but the IRS wasn’t satisfied with that.

It’s all about the cost basis. To properly tax your investment when it is sold, the IRS has to know what you initially paid for it. In financial jargon, this acquisition price is known as the cost basis.

It isn’t always easy to figure the cost basis - factors like splits, mergers, reinvestment of dividends and inherited or gifted investments can make things hazy. The IRS simply doesn’t want to rely on your math anymore - federal government studies estimate that the agency loses up to \$25 billion in tax revenue each year because of cost basis errors.¹

Your broker will send Form 1099-B to the IRS. Each sale of a stock bought in 2011 will generate a 1099-B. You will get a copy; the IRS will get a copy. On that 1099-B form, the gain or loss will be characterized as long-term or short-term.²

The key here is to make sure your broker uses the accounting method you prefer as they report gains or losses. Most brokerages report individual securities using the FIFO method, as that is the IRS default method.³ FIFO is an acronym for “first in, first out” - that is, the shares bought first are the shares sold first.

With the FIFO method, you end up selling your cheapest shares first. In a down market, that’s okay - but in a rising market, many investors favor the specific ID method, in which they identify specific shares they want to sell. Using this method enables you to sell your highest-cost shares first, which can be tax-wise.

More details worth noting. According to the *Wall Street Journal*, the new reporting rules will also apply to REITs, foreign stocks and foreign ETFs classified as stock in 2011. In 2012, the reporting rules will apply to most ETFs and DRIPs in addition to mutual funds. In 2013, the reporting requirements may also apply to derivatives and partnerships.¹

Remember, this does not apply to shares & investments bought before 2011. You will still have to personally track the cost basis of these investments and report the realized gains and losses to the IRS.

By the way, these new IRS reporting rules do not apply to tax-sheltered investment accounts such as 529 plans and IRAs.¹

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Citations

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