



Cost Basis Legislation – What You Should Know

Cost Basis Legislation (CBL) that began in 2011 requires Baird to report adjusted cost basis to the IRS on Form 1099-B (Gross Proceeds) when *Covered* securities are sold, redeemed or exchanged in taxable (i.e., reportable)¹ accounts. Cost basis and the applicable adjustments are an important part of accurately reporting capital gains and losses when filing income tax return(s) because they directly impact your taxable income. Your income tax return(s) must reflect the amounts Baird reports on your tax statements since the IRS will compare your income tax return to what is reported by Baird. You should reconcile any differences and maintain supporting documentation accordingly.²

What is Cost Basis?

The original cost basis is the purchase price of a security including commissions and other fees. The original cost may be adjusted for events such as wash sales, returns of principal, amortization/accretion and corporate actions.

Cost basis (or in some cases, adjusted cost basis) is used to determine capital gains and losses when a security is sold (redeemed or exchanged) for tax purposes. The price at which the security is sold is compared to the cost basis to determine a gain or loss.

Implementation Schedule of Covered Securities

Covered securities are defined based on the year they are acquired:

Type of Security	Acquired After (Effective Date)
Equities ³	January 1, 2011
Mutual funds and dividend reinvestment plans	January 1, 2012
Simple debt ⁴ and options	January 1, 2014
Complex debt ⁵	January 1, 2016
CBL exceptions ⁶	Permanently Noncovered

Securities acquired before the respective effective dates are considered *Noncovered*, and cost basis will not be reported to the IRS. Only securities acquired (and subsequently sold) after the effective date will have their cost basis reported to the IRS.

Debt Instrument Calculations/Default Elections

As of January 1, 2014, CBL required firms to use default calculation methods when determining market discount and bond premium. Firms are now required to follow the CBL default methods unless notified by you in writing that you have made a different election directly with the IRS. Requests to change the default elections on your account for the current tax year must be made by December 30.

Item	Debt Acquired Prior to 1/1/2014	Debt Acquired After 1/1/2014 (CBL Default Method)
Market discount computation method	Constant Yield	Acquired in 2014 - Ratable Accrual Method (Straight Line); Acquired after 1/1/15 - Constant Yield
Recognition of market discount (amount and timing)	Include a <i>prorated</i> amount of market discount in income <i>each year</i>	Recognize the <i>entire</i> amount of market discount income <i>at time of disposition</i>
Bond premium on taxable debt	Amortize	Amortize
Bond premium on tax-exempt debt	Required-Amortize	Required-Amortize

Important: While CBL established the default method to “amortize” bond premium on taxable debt, you must independently make this election directly with the IRS, if applicable.

Reminder When Selling Securities – Select the Tax Lots to Close

CBL requires you to determine which tax lots to close at the time a security is sold, redeemed or exchanged, rather than by the end of the calendar year. Choosing tax lots (the dates and prices that each security was acquired) makes it possible to determine which shares to sell in order to capture gains or losses that are best for your specific tax situation.

You can select the specific tax lots at the time of the trade, or use the default accounting method⁷ you previously chose. *No changes in tax lot selection or accounting method will be possible once the trade settles.* We encourage you to review your tax planning strategy with your tax advisor in order to meet your financial needs and goals.



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Providing Cost Basis When Assets Are Transferred (i.e., Transfer Statements)

When Covered securities are transferred between firms, the IRS requires the delivering firm to send cost basis information for Covered securities to the receiving firm. For gifted securities, the date of the gift, the donor’s adjusted cost basis and the fair market value of the shares on the date of the gift must be captured. For inherited shares, the fair market value used in the estate valuation must be received from the authorized representative of the estate.

Type of Debt Instrument	Acquired After (Effective Date)
Simple debt and options – Form 1099-B Covered	January 1, 2014
<i>Transfer Statements</i> for simple debt and options	January 1, 2015
Complex debt – Form 1099-B Covered	January 1, 2016
<i>Transfer Statements</i> for complex debt	January 1, 2017

Transfer statements for simple debt and options were required starting January 1, 2015, and transfer statements for complex debt were required starting January 1, 2017. Note that if these Covered securities transfer to another firm during 2014 or 2016, respectively, the delivering firm is not required to send cost basis to the receiving firm and the securities become Noncovered at the receiving firm.

Reporting Cost Basis/Gross Proceeds to the IRS

Baird continues to provide cost basis information for both Covered and Noncovered securities on the Client Statement and the Tax Statement (e.g., Form 1099-B) delivered to clients. The primary difference is that cost basis will only be reported to the IRS for Covered securities. Gross proceeds are still reported to the IRS for all securities sold, regardless of whether they are Covered or Noncovered.

Baird 1099 Consolidated Tax Statement

The Baird 1099 Consolidated Tax Statement¹ contains the necessary information to assist you in preparing your income tax return(s).

Form 1099-B includes:

- A *summary* of gains/losses for both Covered and Noncovered securities to correspond to IRS Schedule D (Form 1040) and IRS Form 8949.
- *Detailed* transactions of gains/losses for both Covered and Noncovered securities consistent with IRS Form 8949.
- As applicable, the *entire* amount of market discount will be displayed in the detailed Form 1099-B transactions for Covered Securities, if recognized at disposition.

Note: If applicable, clients can attach a copy of their Baird Tax Statement in lieu of rewriting the same information on Form 8949.⁸

Forms 1099-INT and 1099-OID include:

- The prorated *annual* amount of market discount, bond premium amortization and/or acquisition premium amortization for *Covered* securities, as applicable.

The Supplemental Information section includes:

- The prorated *annual* amount of market discount, bond premium amortization and/or acquisition premium amortization for *Noncovered* securities, as applicable.

Corrected Tax Statements Required For Three Years

Issuers of securities are required to provide the industry with any cost basis adjustments on IRS Form 8937 (Report of Organizational Actions Affecting Basis of Securities) by January 15. This information is critical so that your Tax Statement (i.e., Form 1099) can accurately reflect any required cost basis adjustments (i.e., nondividend distribution/returns of capital and/or the taxability of a corporate action).

Issuers are also required to provide a *revised* Form 8937 if they restate any *prior* year cost basis information (up to three past tax years). In the event an issuer provides Baird a revised Form 8937 (up to three previous tax years), we will issue you and the IRS a corresponding corrected Tax Statement for the applicable tax year. We encourage you to consult your tax advisor with any specific questions related to your tax reporting obligations.

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¹Taxable (i.e., reportable) accounts will receive applicable IRS Forms 1099-DIV, 1099-INT, 1099-OID, 1099-B and 1099-MISC.

²There may be instances when the information you report to the IRS differs from the information reported by Baird. You must be familiar with income tax return reporting rules and be able to verify the differences. Wash sales are an example of a transaction that may cause differences between information reported to the IRS by Baird. You are not allowed to claim losses when reporting wash sales, though the disallowed amount must be reported to the IRS. Baird will identify wash sales within a given account, but it is your responsibility to identify wash sales that are a result of trades across different accounts at Baird or other financial institutions where you hold accounts. All gains from wash sales are also reported.

³Equity securities acquired after January 1, 2011, are considered Covered securities. In addition, real estate investment trusts, certain exchange-traded funds and certain unit investment trusts organized as regulated investment companies are also considered Covered if acquired after January 1, 2011.

⁴Simple debt instruments acquired after January 1, 2014, are considered Covered securities. Simple debt includes instruments that provide for a single fixed payment schedule for which yield and maturity can be determined.

⁵Complex debt instruments acquired after January 1, 2016, are considered Covered securities and include: (a) stepped rate bonds, (b) convertible bonds, (c) stripped bonds or coupons including U.S. Treasury Strips, (d) bonds payable in a foreign currency, (e) tax credit bonds, (f) payment-in-kind bonds, (g) foreign-issued bonds, (h) bonds for which the term is unknown, (i) bonds held as part of an investment unit, (j) contingent payment bonds, (k) variable rate bonds and (l) inflation indexed bonds.

⁶CBL exceptions include certain securities that are *excluded* from CBL and therefore considered Permanently Noncovered. The CBL exception securities include: (a) master limited partnerships, (b) royalty trusts, (c) commodity trusts, (d) unit investment trusts organized as grantor trusts, (e) Widely Held Mortgage Trusts – mortgage pool securities issued by GNMA, FNMA and FHLMC, (f) debt instruments subject to the acceleration of principal and interest such as REMICs and (g) short-term debt instruments issued with a maturity less than one year. For the CBL exceptions, the gross proceeds amounts will be reported to the IRS, although the *cost basis* on these securities is not reported to the IRS. While Baird may provide *preliminary* cost basis on the CBL exceptions, these items may not be complete and may require additional adjustments. The cost basis of the CBL exceptions should be validated against your own records.

⁷If you choose to change your default accounting method, you can do so at any time by notifying your Financial Advisor. If you want to change your method for a specific trade and specify certain tax lots, you must notify your Financial Advisor at the time of the trade or no later than the settlement date. The tax lots for specific sell trades cannot be changed after settlement date.

⁸IRS Form 8949 (Sales and Other Dispositions of Capital Assets) is used to report the detailed gross proceeds and cost basis transactions; the Baird Tax Statement is designed in a similar format to Form 8949. To save time, clients can attach a copy of their Baird Tax Statement to the Form 8949 and Schedule D, as applicable (refer to IRS Instructions for Form 8949 and Schedule D for specific instructions when attaching your Baird Tax Statement).

The tax information contained herein is provided for informational purposes only and is general in nature. It should not be construed as legal or tax advice. Baird does not provide legal or tax advice. Please consult your tax advisor regarding your own specific tax situation.

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