

## 2014 Cost Basis Legislation – What You Should Know

Cost Basis Legislation 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)<sup>1</sup> accounts.

Cost basis and the applicable adjustments are an important part of accurately reporting capital gains and losses when filing tax returns because it directly impacts your taxable income. Your tax return(s) must reflect the amounts Baird reports on Forms 1099 since the IRS will compare your tax return to what is reported by Baird. You should reconcile any differences and provide supporting documentation accordingly<sup>2</sup>.

### 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 On or After (Effective Date)
Equities <sup>3</sup>	January 1, 2011
Mutual funds and dividend reinvestment plans	January 1, 2012
Simple debt <sup>4</sup> and options	January 1, 2014
Complex debt <sup>5</sup>	January 1, 2016
CBL exceptions <sup>6</sup>	Permanently Noncovered

For tax year 2014, the definition of Covered securities has been expanded to include simple debt<sup>4</sup> and options acquired and sold in 2014 or thereafter.

*Note: equity securities, mutual funds and dividend reinvestment plans that were Covered securities in 2011, 2012 and/or 2013 continue to be Covered securities in 2014 and thereafter.*

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

Starting January 1, 2014, CBL requires firms to use default calculation methods when determining market discount and bond premium. Going forward, firms are required to follow the CBL default methods unless notified by you in writing that you have made a different election directly with the IRS. Any written notifications received from you will be implemented prospectively only.

Item	Debt Acquired Prior to 1/1/2014	Debt Acquired After 1/1/2014 (CBL Default Method)
Market discount computation method	Constant Yield	Ratable Accrual Method (Straight Line)
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 method<sup>7</sup> 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.

## 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. In either case, the Covered status is carried forward.

Type of Debt Instrument	Acquired On or 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 are required starting January 1, 2015, and transfer statements for complex debt are required starting January 1, 2017. Note that if these Covered securities are transferred 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.

- For example, if simple debt is purchased through firm A in 2014, it becomes Covered. Subsequently, if firm A transfers that security to firm B in 2014, the simple debt transaction becomes Noncovered at firm B because the cost basis transfer statement is not required for transfers of simple debt during 2014. Whenever the simple debt transaction is sold at firm B it will be considered Noncovered, and cost basis will not be reported to the IRS.
- Conversely, if simple debt is purchased through firm A in 2014, it becomes Covered. Subsequently, if firm A transfers that security to firm B in 2015, the simple debt transaction remains Covered at firm B because the cost basis transfer statement is required for transfers of simple debt during 2015 and thereafter. Whenever the simple debt transaction is sold at firm B it will be considered Covered, and cost basis will be reported to the IRS.

## 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 Tax Statement

The Baird Tax Statement<sup>1</sup> contains the necessary information to assist you in preparing your taxes.

### Form 1099-B includes:

- A *summary* of gains/losses for both Covered and Noncovered securities to correspond to the IRS Schedule D (Form 1040) and the IRS Form 8949.
- *Detailed* transactions of gains/losses for both Covered and Noncovered securities consistent with the 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<sup>8</sup>.*

### 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 3 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., Forms 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.

## 2014 Tax Statement Mailing Dates

Baird will continue to process the 2014 Tax Statements<sup>1</sup> in two waves:

- Wave I will be mailed by **February 17, 2015**
- Wave II will be mailed by **March 16, 2015**<sup>2</sup>

We anticipate the *majority* of accounts will be mailed on or before February 17 (in Wave I) *with the exception of accounts that held debt instruments*.

Also, certain accounts will be held and not mailed by February 17 if a select third party (e.g., exchange-traded fund, mutual fund, real estate investment trust and unit investment trust) has not provided their year-end tax information adjustments prior to the processing deadline date. Any remaining accounts not mailed in Wave I, including accounts that held debt instruments, will be mailed by March 16 (in Wave II).

**Note:** As applicable, the 2014 Tax Statement mailed on February 17 will contain an important message indicating if you have a *related* account(s) in your household which will be mailed on March 16. *Please wait until you receive all 2014 Tax Statements to file your tax return(s).*

**Reminder:** A 2014 Tax Statement will be issued if you received dividends or interest totaling at least \$10 in aggregate or if you received any gross proceeds<sup>10</sup>.

## Convenient Access to Your Baird Tax Documents

Baird offers clients a variety of methods to access your tax documents (in addition to the copy received in the mail) including:

- **Baird Online** – a PDF copy of each of your tax documents will be available on Baird Online before your copy is received in the mail.
- **Turbo Tax®** - you can download the Tax Statement, REMIC/WHMT Tax Statement and/or Form 1099-R directly into Turbo Tax®.
- **CSV File** - you (and your tax preparer) can download the Tax Statement into a CSV (comma-separated value) file. The CSV file can then be electronically transferred into most professional tax accounting software.

Visit [rwbaird.com/taxes](http://rwbaird.com/taxes) for additional information.

## Who to Call with Questions

As always, we encourage you to contact your Baird Financial Advisor if you have any questions. **For specific questions related to your tax reporting obligations, consult with your tax advisor or the IRS (1-800-829-1040).**

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

<sup>2</sup> There may be instances when the information you report to the IRS differs from the information reported by Baird. You must be familiar with 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 within different accounts at Baird or other financial institutions where you hold accounts. All gains from wash sales are also reported.

<sup>3</sup> Equity 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.

<sup>4</sup> Simple 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.

<sup>5</sup> Complex 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.

<sup>6</sup> CBL 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 (f) 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.

<sup>7</sup> If 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.

<sup>8</sup> The IRS Form 8949 (Sales and Other Dispositions of Capital Assets) is used to report the detailed gross proceeds and cost basis transactions; the Baird 2014 Tax Statement is designed in a similar format to Form 8949. To save time, clients can attach

a copy of their Baird 2014 Tax Statement to the Form 8949 and Schedule D, as applicable (refer to IRS 2014 Instructions for Schedule D and IRS 2014 Instructions for Form 8949).

<sup>9</sup> The March 16, 2015 mailing date is based on a 30-day extension granted by the IRS to reduce the number of corrected 1099s you may receive.

<sup>10</sup> A 2014 Tax Statement will be issued if your taxable account meets or exceeds any of the IRS minimum thresholds as follows: (a) \$10 or more of dividends, capital gain distributions, nondividend distributions, corporate interest, treasury interest, tax-exempt interest/dividends, original issue discount, treasury original issue discount, market discount or substitute payments, (b) \$600 or more of any cash liquidation distributions, royalty

distributions or other income distributions, (c) at least one gross proceeds transactions, (d) any federal backup withholding, (e) any state withholding, or (f) any foreign tax paid.

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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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