



## **Cost-Basis Reporting Law May Prove Expensive to Financial Services Firms that Delay Systems Upgrades**

*Compliance with New Regulations, Avoidance of IRS Penalties to Require Complex Additional Systems Capabilities, Advises Consultant Jane Stabile*

**Boston – January 5, 2010** – The cost-basis reporting requirements of the Emergency [Economic Stabilization Act of 2008](#) carry many potential pitfalls for financial services firms that do not act soon to revamp their information-gathering and reporting capabilities, according to Boston-based financial systems consultant [Jane M. Stabile](#).

Accounting for the adjusted-cost basis of securities may seem relatively straightforward, but the detailed and deceptively complex nature of the process will pose challenges that exceed functionalities of many existing systems, maintains Stabile, principal of [IMP Consulting](#).

“We have compiled a [few examples of typical situations](#) that investment firms will face as they attempt to comply with the new law. The system enhancements they will have to make will not be a mere plug-and-play project. It could take three to six months of planning and testing. To date we have not seen very much attention to this at the executive level within the financial services industry,” she stated.

Stabile also cited a mid-2009 [survey of financial services professionals](#) by [Celent](#) and [Wolters Kluwer](#), which noted that fewer than 20 percent of affected firms – broker-dealers, banks, mutual funds, financial advisers, custodians, hedge funds and transfer agents - that must comply or rely on a partner to comply with the law’s reporting mandates had allocated funds for making upgrades.

### **IRS Enforcement Portends Little Leeway for Reporting Firms**

The Internal Revenue Service expects to generate substantial additional tax revenue from the measure, which is designed to prevent investors from underreporting gains and over-reporting losses. But now the burden of accounting for the original cost of securities will shift from individuals to the executing firms. Penalties for non-compliance, based on the number of errors per IRS 1099 form, can add up quickly.

### **Wash Sales, Account Bifurcation, Account Transfers All Potential Pitfalls**

Stock acquired on or after January 1, 2011 will be the first type of security subject to the new reporting rules. Share lots will have to be tracked separately, based on transactions conducted before and after that date. This “bifurcation” of accounts will not be a simple matter, according to Stabile, and there may be additional complexities related to dividend reinvestment and the reporting of short-term versus long-term gains.

Identifying wash-sale securities and accounting for their adjusted basis also looms problematic. Accounting systems will have to track the securities that triggered the wash sale until the point where they are sold, and will have to make complex calculations that track the adjusted basis and the holding period.

Additional difficulties in generating accurate cost basis may arise from calculating the effects of corporate events such as stock splits, mergers, and spinoffs. The same holds true for adjusting the basis of a stock that is donated to charity. Additionally, when an investor moves an account from one firm to another, the onus will be on the old firm to supply the new one with accurate cost-basis information.

"It used to be that only a small number of brokerage firms offered cost basis calculations for their clients to assist them with tax preparation. Now it is a legal requirement for all brokerage firms, and that can affect transfer agents, banks, mutual funds and any firms that conduct securities transactions for the consumer. Firms who have not scoped the effort and potential cost of compliance may find themselves unpleasantly surprised at the impact to their 2010 budgets," concluded Stabile.

**About [IMP Consulting](#)**

IMP Consulting is a boutique firm of investment industry experts – traders, portfolio managers, compliance officers, and operations and IT professionals – established in 2003 to enable asset management firms to derive maximum performance and full potential from investment systems. IMP's customized solutions include strategic advice; system selection, implementation, integration, and upgrades; compliance; order management and execution management systems audit; compliance; and accounting.

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