Olson Tax Planning

Olson Tax Planning
106-19 Metropolitan Avenue
Forest Hills, NY 11375
718.551.8244 Fax: 718.268.8031
Email: info@OlsonTFP.com
www.OlsonTFP.com

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Should you care about "basis"? Here are the basics for understanding cost basis.

You should care because you have the opportunity to minimize your taxes when you sell stocks, mutual funds and other securities. The sale of a security results in a gain or a loss. This capital gain or loss can be either short term or long term. And the gain or loss will be taxed at different rates (long term capital gains at 15% or short term capital gains at your ordinary rate or as much as 35% or more including state taxes[i]). Capital losses can also offset capital gains. Over time you can minimize your taxes by being tax aware when you sell. The starting point for this tax management is identifying the basis or cost of the securities you hold. Of course, don't let taxes be the sole reason for buying or selling!

> Here's a typical situation: A person I know recently wanted to sell some but not all of her Citigroup stock. She purchased the stock on 12 different dates such that some stock was owned at $40 a share while some was owned at $2 a share. She decided to sell the high basis stock in order to lock in the losses and use the losses to offset capital gains from another stock sale. Net impact was no tax owed.
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> And here's an example for the numerically inclined: You want to sell 100 Citigroup at $5. You purchased two lots of C at two different times – first 50 at $40 then an additional 50 at $2. Based on the first in/first out (FIFO) method, your realized loss is $35 per share ($5 minus 40). Based on specific identification, you could choose to gain $3 per share ($5 minus $2).

You need to act! Since you must identify the cost method at the time of each sale, <u>now</u> is the time to talk to your financial advisor about the best method for you. You are in the best position to benefit from basis tracking if you choose the "specific identification" method. The other methods – first in/first out or average cost – do not give you the flexibility or information to manage taxes effectively.

We are in the middle of the period where broker dealers and others are implementing the new basis rules. The IRS requires the custodians who hold your securities to track basis and report that basis to the IRS as well as to you when you sell. In 2011, basis tracking began for stocks and ETFs. In 2012, tracking will begin for mutual funds and in 2013 bonds and all other securities will be tracked. The IRS implemented cost basis reporting primarily to close the "tax gap" because it believes investors were manipulating basis in order to minimize gains or maximize losses.

Note: The IRS will now also be able to track wash sales, so you must be careful to follow wash sale rules, which can be complicated.

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[i] Did you know that New York and NYC tax capital gains at the ordinary NY and NYC rates?