# Phase III Cost Basis Reporting: The Basics

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**White Paper**

In April 2013, the U.S. Treasury Department and IRS issued final regulations for Phase III of the Cost Basis Reporting (CBR) requirements instituted in 2011. Per these requirements, brokers and other transfer agents must report a customer's adjusted basis for certain covered securities -- securities futures contracts, debt instruments and options -- acquired on January 1, 2014 or later. They are also required to classify any gain or loss as long-term or short-term for these covered securities.

This paper focuses on how to comply with Phase III requirements when generating 1099-B statements; it supplies examples of cost basis calculations for securities futures contracts, different options and covered debt instruments and provides instruction on how to complete 1099-B forms for these securities. The paper also covers amortization rules, which can make calculating cost basis for debt instruments highly complex.

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# Content

## Section 1: INTRODUCTION

In an effort to police tax shelters and close the so-called tax gap, estimated at more than 1.2 trillion dollars, President George W. Bush signed the Emergency Economic Stabilization Act of 2008 (H.R. 1424 or EESA) on October 3, 2008. EESA ushered in a new era of tax reporting requirements that now require brokers, in addition to individual taxpayers, to accurately report cost basis data to the IRS. Three phases of these Cost Basis Reporting (CBR) regulations have been rolled out over time. Phase I included equities, Phase II included mutual funds and ETFs and Phase III requires cost basis reporting for options, securities futures contracts, and less complex debts acquired on January 1, 2014 or later.

Phase III is implemented by enhancing 26 CFR §1.6045-1 and §1.6045A-1. The key changes are:

1. The definition of "security" in §1.6045-1(a)(3) now includes securities futures contracts and certain options. Securities futures contracts are also called single-stock futures and abbreviated as SSF.
2. The definition of "specified securities" in §1.6045-1(a)(14) now includes debt instruments, options, and securities futures contract.
3. The definition of "covered securities" in §1.6045-1(a)(15)(i) now includes debt instruments, options, and securities futures contract that are acquired on January 1, 2014 or later.

Paragraphs (m) and (n) are also fleshed out to cover the reporting requirements for options and debt instruments, respectively. Phase III does not create new tax obligations or computations; but it does create additional reporting requirements for brokers. In this sense, CBR in general and Phase III in particular are *merely* reporting regulations that affect brokers and transfer agents. They do *not* change the rules for the taxpayer.

This paper focuses on the impact of Phase III on the generation of 1099-B statements by brokers. We discuss transfer reporting as defined by §1.6045-1(a)(15)(i) in our white paper, [Phase III Cost Basis Reporting: A Guide to Complying with Expanded Transfer Statement Information Requirements].

For the purposes of this paper, it is important to explain what is meant by "Form 1099-B." Technically speaking, each non-section-1256 closing transaction requires its own 1099-B form. In addition, if some of the gains or losses are long-term and some are short-term, separate forms are required for both types of gains for the same security. Throughout this paper we will try to denote when multiple forms can be combined for ease of reporting. However, it is important to note that a broker will typically take multiple 'forms' for a single taxpayer and collapse them to a single 'row' of data thereby creating a single document containing all of that taxpayer's 'forms.' Therefore the reader should consider the term 'form' to be synonymous with 'row of data.'

## Section 2: WHAT IS COVERED AND WHAT IS EXEMPT

Before we define covered security, let us first define specified security. For Phase III, a specified security is a stock, a debt instrument, an option, or a securities futures contract. For purposes of this paper, the term "stock" also includes any security-like vehicle treated as a stock, such as ADRs and mutual funds. In addition to being specified, these securities are also considered to be covered if, during the time frame defined by §1.6045-1, stocks and debt are acquired with cash; options are granted or acquired for cash; and securities futures contracts are entered into. For example, any stock is a specified security. But only a stock purchased with cash on or after January 1, 2011, is also covered. In general, almost all stocks, less complicated debt instruments, options, and SSFs acquired starting in 2014 are covered.

Before Phase III, stock was the main type of covered security. With Phase III, less complicated debt instruments, most options, and securities futures contracts are now also covered. Thus a broker must adhere to CBR on these securities if they are acquired or sold short on January 1, 2014, or later. Phase III did carve out a new non-specified security: Any debt instrument whose maturity is one year or less at the time of issuance *is not a specified security*. However, a longer term instrument with less than one year in its remaining term *is still a specified security*. Aside from that, the rules on exemption have not changed and this paper will not delve into exemption any further.

A broker can be exempt from CBR requirements in several ways:

1. The security in the transaction is a non-covered security or is specifically exempt, such as foreign currency and agricultural commodities; or
2. The customer in the transaction is exempt; or
3. In a chain of broker-to-broker transactions, another broker has the reporting requirement; or
4. The transaction is considered to have been conducted entirely outside the United States; or
5. The acquisition occurred prior to specified dates depending on the type of security.

## Section 3: SECURITIES FUTURES CONTRACTS

A securities futures contract is a future on a single security or narrow-based securities index. For a precise definition, look to section 1234B(c), which relies on section 3(a)(55)(A) of the Securities Exchange Act of 1934. So be aware that the mere inclusion of the term “futures” in the name of a financial instrument does not make it a securities futures contract. The more common term for a securities futures contract is SSF, for single stock futures. Some examples of “futures” that are not SSFs are S&P 500 index futures, Gold Futures traded on the CME, or Oil Futures traded on the NYMEX. However, a Future on the SPY (S&P 500 Unit Investment Trust) *does* qualify as a SSF.

All gain/loss from a short is treated as short-term. All gain/loss from a long can be long-term or short-term depending on the holding period. If a taxpayer receives a security as physical settlement of a futures contract, he gets to tack the contract holding period to the security holding period per 1223(14).

In practice, SSFs are traded on a margin account. The fact that a contract is mark-to-market does not affect its tax treatment. Draw downs on a margin account tied to SSFs are treated as a loan, and therefore are not taxable events.

**Example 1 – Securities futures contracts**
A broker executes trades for an investor.

On December 12, 2013, the investor enters into a securities futures contract for 100 shares of XYZ at a future price of \$4. On January 14, 2014, the investor acquires another contract for 75 additional shares of XYZ at a future price of \$5.
On February 14, 2014, the investor acquires another contract for 50 shares of XYZ at a future price of \$6.
All three batches of futures expire on the same day.
On August 12, 2014, prior to the expiration, the investor closes all 225 contracts through cash settlement.

The future price of that contract of XYZ on that day is \$5.50 and the total cash exchanges net to:

1. He receives \$150.00 for the 100 contracts entered into on December 12, 2013
2. He receives \$37.50 for the 75 contracts entered into on January 14, 2014
3. He pays \$25.00 for the 50 contracts entered into on February 14, 2014

The broker should file two forms 1099-B: one for the 100 buy (Table 1B) that are uncovered and one for the combined 125 buy that are covered. Let us first discuss the form for the combined 125, Table 1A. Despite emanating from two distinct trades, these two can be reported together because both are closed on the same date and are short-term. If one was short-term and the other was long-term or if the two were sold on different days, then two forms would be needed.

**Table 1A - First 1099-B form for securities futures contracts: 125 shares of XYZ SFC**

Box 1d Gross Proceeds is the sum of the $37.50 and -$25.00, or $12.50.
Box 1e Cost Basis is $0.
Boxes 1f and 1g apply to wash sales and market discounts, discussed later.
Boxes 1a and 1c should be straightforward.
Box 1b can be left empty since this report comprises multiple purchases.
Box 2 is short-term, since both SSFs were held for less than a year.
Box 3 is checked.
Box 4 assume $0.
Box 5 is unchecked.
Box 6 is Gross Proceeds, since that is what's reported.
Box 7 deals with capital structure change and is not covered by this paper.
Boxes 8, 9, 10, and 11 only apply to regulated futures, foreign currency, or Section 1256 option contracts.
Box 13 is not applicable.

| | |
|---|---|
| Applicable check box on Form 8949<br>A | |
| 1a Description of property (Example 100 sh.XYZ Co.)<br>125 shares of XYZ SFC | |
| 1b Date Acquired | 1c Date sold or disposed<br>August 12, 2014 |
| 1d Proceeds<br>$12.50 | 1e Cost or other basis<br>$0.00 |
| 1f Code, if any | 1g Adjustments |
| 2 Type of gain or loss:<br>Short-term X<br>Long-term | 3 Check if basis reported to IRS<br>X |
| 4 Federal income tax withheld<br>$0.00 | 5 Check if non-covered security |
| 6 Reported to IRS:<br>Gross proceeds X<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |
| 8 Profit or (loss) realized in 2014 on closed contracts | 9 Unrealized profit or (loss) on open contracts - 12/31/2013 |
| 10 Unrealized profit or (loss) on open contracts - 12/31/2014 | 11 Aggregate profit or (loss) on contracts |
| 12 | 13 Bartering |

The very first box "Applicable check box on Form 8949" currently supports these codes:

| | | |
|---|---|---|
| A – short-term, reported to IRS | D – long-term, reported to IRS | X – holding period unknown |
| B – short-term, not reported | E – long-term, not reported | |

**Table 1B - Second 1099-B form for securities futures contracts: 100 shares of XYZ SFC**

The 2013 buy also requires reporting, but not as much information is needed.
For a non-covered security, Box 5 should be checked.
Then Boxes 1b, 1e, 2, and 3 are now optional.
Box 1d is the $150 received.

| | |
|---|---|
| Applicable check box on Form 8949<br>B | |
| 1a Description of property (Example 100 sh.XYZ Co.)<br>100 shares of XYZ SFC | |
| 1b Date Acquired | 1c Date sold or disposed<br>August 12, 2014 |
| 1d Proceeds<br>$150.00 | 1e Cost or other basis |
| 1f Code, if any | 1g Adjustments |
| 2 Type of gain or loss:<br>Short-term<br>Long-term | 3 Check if basis reported to IRS |
| 4 Federal income tax withheld<br>$0.00 | 5 Check if non-covered security<br>X |
| 6 Reported to IRS:<br>Gross proceeds X<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |

## Section 4: OPTIONS

Phase III now requires a broker to adhere to CBR for most options. The required information is slightly different from that of stocks. Not all options are covered in Phase III. The general types of options covered in Phase III are the following types acquired or granted on or after January 1, 2014:

1. An option on one or more specified securities
2. An option on financial attributes of specified securities
3. A warrant or a stock rights issue

Two types of options that are not covered by Phase III are options in an investment unit and compensatory options. The former is scheduled to be covered in 2016.

The broker must first discern whether an option is subject to section 1256, which the Internal Revenue Code (IRC) defines as the following:

1. Regulated futures contract
2. Foreign currency contract
3. Non-equity option
4. Dealer equity option
5. Dealer securities futures contract, not to be confused with securities futures contract

Section 1256 options are reported as if they were regulated futures contracts, meaning they may be reported in an aggregate form. A non-1256 option is reported based on whether it is physically settled or cash settled. Also note that now that 1256 options are covered, their mark-to-market reporting needs to be computed on a 1099-B in the same way that regulated futures contracts are handled. The end of this section includes an example on 1256 options.

**Example 2 – An option not subject to Section 1256 that is physically settled**
On 05/14/2014, the investor writes a put option on 1000 shares of XYZ with a strike of $10 a share. The investor receives $600 in premium. The put expires on 09/16/2014.
On 09/16/2014, the option is exercised. The investor pays $10,000 for 1000 shares of XYZ.
On 10/16/2015, the investor sells the 1000 shares of XYZ for $9,000.

In this example, no reporting is required in 2014 for the option, since the exercise or assign of a physically settled option does not require its own reporting. However, any payment related to the option is absorbed by the reporting of the underlying asset when it must be reported. Pub 550 instructs the writer of a put or buyer of a call to adjust the basis; the buyer of a put or writer of a call should adjust the proceeds.[1]

| **Table 2 - An option not subject to Section 1256 that is physically settled** | | |
|---|---|---|
| The date in Box 1b is the date of the exercise. The cost of the shares must incorporate all payments related to the option. In this case, the investor received $600 in premium, which reduces the cost basis from the $10,000 paid at the time of option exercise.<br><br>For box 6, we adjusted the basis to account for the premium, not the Gross Proceeds. Thus we check off Gross Proceeds and not net proceeds.<br>Again we hold off on wash sales. Also boxes 8, 9, 10, 11 and 13 do not apply. | Applicable check box on Form 8949<br>**C** | |
| | 1a Description of property (Example 100 sh.XYZ Co.)<br>**1000 shares of XYZ** | |
| | 1b Date Acquired<br>**9/16/2014** | 1c Date sold or disposed<br>**10/16/2015** |
| | 1d Proceeds<br>**$9,000** | 1e Cost or other basis<br>**$9,400** |
| | 1f Code, if any | 1g Adjustments |
| | 2 Type of gain or loss:<br>Short-term<br>Long-term **X** | 3 Check if basis reported to IRS<br>**X** |
| | 4 Federal income tax withheld<br>**$0.00** | 5 Check if non-covered security |
| | 6 Reported to IRS:<br>Gross proceeds **X**<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |

### Example 3 – An option not subject to Section 1256 that is cash-settled

On 05/14/2014, the investor writes a put option on 1000 shares of XYZ with a strike of $10 a share. The investor receives $600 in premium. The put expires on 09/16/2014.
On 09/16/2014, the price of XYZ is $9.30, and therefore the option is exercised, forcing the investor to pay $700 in settlement.

| Table 3 - An option not subject to Section 1256 that is cash-settled | | |
|---|---|---|
| This reporting looks like the following:<br><br>The Date Acquired is the original write date.<br>The Proceeds are the $600 received minus the $700 paid. Since this is a netted number, Box 6 is checked off as Net Proceeds. The basis is always $0 when you write an option.<br>The gain or loss in such option cases is always short-term. | Applicable check box on Form 8949<br>A | |
| | 1a Description of property (Example 100 sh.XYZ Co.)<br>1000 shares of XYZ | |
| | 1b Date Acquired<br>5/14/2014 | 1c Date sold or disposed<br>9/16/2014 |
| | 1d Proceeds<br>($100) | 1e Cost or other basis<br>$0 |
| | 1f Code, if any | 1g Adjustments |
| | 2 Type of gain or loss:<br>Short-term X<br>Long-term | 3 Check if basis reported to IRS<br>X |
| | 4 Federal income tax withheld<br>$0.00 | 5 Check if non-covered security |
| | 6 Reported to IRS:<br>Gross proceeds<br>Net proceeds X | 7 Check if loss is not allowed based on amount in 1d |

### Example 4 – An option not subject to Section 1256 that is Cash-Settled and expires worthless

On 05/14/2014, the investor writes a put option on 1000 shares of XYZ with a strike of $10 a share. The investor receives $600 in premium. The put expires on 09/16/2014.
On 09/16/2014, the option expires worthless.

| Table 4 - An option not subject to Section 1256 that is cash-settled and expires worthless | | |
|---|---|---|
| This reporting looks like the following:<br><br>The Date Acquired is the original write date.<br>The Proceeds are the $600 received. Box 6 is checked off as Net Proceeds, since Box 1d would have been netted with any cash used to settle the option upon its expiration (in this case $0). The basis is always $0 for a cash-settled option.<br>The gain or loss in such option cases is always short-term. | Applicable check box on Form 8949<br>A | |
| | 1a Description of property (Example 100 sh.XYZ Co.)<br>1000 shares of XYZ | |
| | 1b Date Acquired<br>5/14/2014 | 1c Date sold or disposed<br>9/16/2014 |
| | 1d Proceeds<br>$600 | 1e Cost or other basis<br>$0 |
| | 1f Code, if any | 1g Adjustments |
| | 2 Type of gain or loss:<br>Short-term X<br>Long-term | 3 Check if basis reported to IRS<br>X |
| | 4 Federal income tax withheld<br>$0.00 | 5 Check if non-covered security |
| | 6 Reported to IRS:<br>Gross proceeds<br>Net proceeds X | 7 Check if loss is not allowed based on amount in 1d |

## Example 5 – Section 1256 options

Consider this series of trades.

On 01/14/2014, the investor enters into a regulated future for a NY Bond for a future price of $98,750.
On 01/15/2014, the investor enters into another of the same regulated future for a future price of $99,000.
On 02/14/2014, the investor buys a put on Treasury Bond, paying $500. The put expires in 2016.
On 03/14/2014, the investor buys a call on a CA Bond, paying $300. The call expires on 09/15/2014.
On 05/14/2014, the investor writes a call on the two regulated futures for the NY Bond, receiving $600.
On 09/15/2014, the 03/14 CA Bond option expires.
On 09/16/2014, the 05/14 option is exercised. The investor receives $200,000 and sells the two futures purchased on 01/2014 and 01/2015.
At year end, the put on Treasury Bond is valued at $450.

Two forms 1099-B are needed. The regulated futures on the NY Bond (Table 5A) may be reported together; the options on the Treasury and CA Bonds, (Table 5B) may be reported together. The broker does not have to break out the 40% short-term vs 60% long-term for gain/loss. The broker only needs to fill out 1a, 4, 8, 9, 10, and 11.

**Table 5A - Regulated futures on NY Bond**

The two regulated futures on the NY Bond were entered into at a combined futures price of $197,750. They were then closed for a future price of $200,000, resulting in the $2,250 Realized Profit.

| | |
|---|---|
| Applicable check box on Form 8949 | |
| 1a Description of property (Example 100 sh.XYZ Co.)<br>**RFC** | |
| 1b Date Acquired | 1c Date sold or disposed |
| 1d Proceeds | 1e Cost or other basis |
| 1f Code, if any | 1g Adjustments |
| 2 Type of gain or loss:<br>Short-term<br>Long-term | 3 Check if basis reported to IRS |
| 4 Federal income tax withheld<br>**$0.00** | 5 Check if non-covered security |
| 6 Reported to IRS:<br>Gross proceeds **X**<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |
| 8 Profit or (loss) realized in 2014 on closed contracts<br>**$2,250.00** | 9 Unrealized profit or (loss) on open contracts - 12/31/2013<br>**$0.00** |
| 10 Unrealized profit or (loss) on open contracts - 12/31/2014<br>**$0.00** | 11 Aggregate profit or (loss) on contracts<br>**$2,250.00** |
| 12 | 13 Bartering |

**Table 5B - Options on the Treasury and CA Bonds**

The realized profit on the options is the $600 received on 05/14 minus the $300 paid on 03/14, totaling $300.
The unrealized loss is from the $50 loss on the still open option on the US Treasury. The purchase price is $500 whereas the year-end price is $450, resulting in an Unrealized Loss of $50.
The aggregate is the sum of Boxes 8, 9, and 10.

| | |
|---|---|
| Applicable check box on Form 8949 | |
| 1a Description of property (Example 100 sh.XYZ Co.)<br>**1256 Options** | |
| 1b Date Acquired | 1c Date sold or disposed |
| 1d Proceeds | 1e Cost or other basis |
| 1f Code, if any | 1g Adjustments |
| 2 Type of gain or loss:<br>Short-term<br>Long-term | 3 Check if basis reported to IRS |
| 4 Federal income tax withheld<br>**$0.00** | 5 Check if non-covered security |
| 6 Reported to IRS:<br>Gross proceeds **X**<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |
| 8 Profit or (loss) realized in 2014 on closed contracts<br>**$300.00** | 9 Unrealized profit or (loss) on open contracts - 12/31/2013<br>**$0.00** |
| 10 Unrealized profit or (loss) on open contracts - 12/31/2014<br>**($50.00)** | 11 Aggregate profit or (loss) on contracts<br>**$250.00** |
| 12 | 13 Bartering |

**Example 6 – Multi-year Section 1256 options**

Let us continue the example with the put on the US Treasury.

Recall on 02/14/2014, the investor buys a put on Treasury Bond, paying $500. The put expires in 2016.
At the end of 2014, the put on Treasury Bond is valued at $450.
The taxpayer continues to hold this option and at the end of 2015, this put is valued at $520.

For 2015 tax year reporting, the broker must fill out a form 1099-B for the options on the Treasury (Table 6). The broker does not have to break out the 40% short-term vs 60% long-term for gain/loss. The broker only needs to fill out 1a, 4, 8, 9, 10, and 11.

<table>
<tr><th colspan="3">Table 6 - Multi-year Section 1256 options</th></tr>
<tr><td rowspan="12">In Box 8, the Realized Profit or (loss) on the options is $0.<br><br>In Box 9, the Unrealized Profit or (loss) on open contracts on 12/31/2014 is ($50), the amount from Box 10 of the 2014 form.<br><br>In box 10, the unrealized profit or (loss) for this year is $20, the market value of $520 less the purchase price of $500.<br><br>In Box 11, the Aggregate is the sum of Boxes 8 and 10 minus box 9: $0 (Box 8) + $20 (Box 10) - (-$50) (Box 9) = $70.<br><br>As a sanity check, the Aggregate (Box 11) is the current market value ($520) less the price on 12/31/2014 ($450).</td><td colspan="2">Applicable check box on Form 8949<br>**A**</td></tr>
<tr><td colspan="2">1a Description of property (Example 100 sh.XYZ Co.)<br>**1256 Options**</td></tr>
<tr><td>1b Date Acquired</td><td>1c Date sold or disposed</td></tr>
<tr><td>1d Proceeds</td><td>1e Cost or other basis</td></tr>
<tr><td>1f Code, if any</td><td>1g Adjustments</td></tr>
<tr><td>2 Type of gain or loss:<br>Short-term<br>Long-term</td><td>3 Check if basis reported to IRS</td></tr>
<tr><td>4 Federal income tax withheld<br>**$0.00**</td><td>5 Check if non-covered security</td></tr>
<tr><td>6 Reported to IRS:<br>Gross proceeds **X**<br>Net proceeds</td><td>7 Check if loss is not allowed based on amount in 1d</td></tr>
<tr><td>8 Profit or (loss) realized in 2015 on closed contracts<br>**$0.00**</td><td>9 Unrealized profit or (loss) on open contracts - 12/31/2014<br>**($50.00)**</td></tr>
<tr><td>10 Unrealized profit or (loss) on open contracts - 12/31/2015<br>**$20.00**</td><td>11 Aggregate profit or (loss) on contracts<br>**$70.00**</td></tr>
<tr><td>12</td><td>13 Bartering</td></tr>
</table>

## Section 5: COVERED DEBT INSTRUMENTS

With Phase III, debt instruments seem to create the most questions for brokers. This is probably due to the fact that debt instruments are complicated, widely-held, and are the only specified instruments whose cost basis may change due to amortization rules. This uncertainty is well founded. As we shall quickly see, Phase III is much more complicated for debt instruments than all other covered instruments in Phases I - III.

First, §1.6045-1 addresses what it considers to be a debt instrument. An instrument is a debt if:

1. It is defined as such in §1.1275-1(d), which means any instrument or contractual arrangement that constitutes indebtedness; or
2. If the IRS considers it a debt; or
3. The issuer has classified it as a debt, unless the broker has reasons to believe otherwise.

A debt instrument is very likely covered in Phase III if it carries a well-defined[2] payment schedule from which yield may be easily determined. If the payment schedule is not pre-determined, that debt instrument is likely non-covered, such as with variable rate debt instruments. Even if the payment structure is well-defined, a debt instrument may still be non-covered if it has 1-yr or less to maturity at issuance or if it is specifically mentioned in §1.1272-1(n)(2)(ii). The exception generally applies to more exotic debt instruments, such as non-USD or convertible bonds. But even if a debt instrument is a vanilla fixed-coupon bond, it can be categorized as non-covered if the terms of that bond are unavailable to the broker within 90 days of the acquisition date. There are other criteria that also can cause a debt instrument to not be covered in Phase III.

Debt instruments that are covered in Phase III are sometimes called 'Less Complicated Debt' or LCD. Debt instruments that remain non-covered are sometimes called 'More Complicated Debt' or MCD, and are scheduled to become covered in 2016.

Correctly reporting on debt instruments can be quite complex since brokers must file several 1099 forms: 1099-B, 1099-INT and 1099-OID. Also the level of detail of these three forms varies. Table 7 describes, generally, how the form(s) should be filed for a given customer.

**Table 7 - Covered debt instruments: Guidelines for filing 1099-B, 1099-INT and 1099-OID**

| Form | Level of detail |
|---|---|
| 1099-B | Per security per sale or closing transaction (e.g., maturity or early call). In many cases, this becomes taxlot-level detail. |
| 1099-INT | Aggregated to one per customer or per account, reporting separately interest, premium (if amortized) and market discount (if accreted). |
| 1099-OID | Per security of the exact same election, holding, period and initial basis (e.g., the same OID bonds held for different period would each have its own form). |

Adding both complexity and flexibility, the IRS allows the broker to report qualified stated income on an OID bond either on the same 1099-OID where the OID is reported or on a completely separate 1099-INT. Also, 1099-INT and 1099-OID forms each have boxes for Interest from US Treasury and Savings bonds.

## Section 6: INVESTOR ELECTIONS UNDER §1.6045-1(n)(4)

Phase III requires brokers to support five taxpayer-selected elections. Table 8 lists these elections and the implications. For completeness, we also list two items that offer no election but are closely related to debt instruments.

**Table 8 - Investor elections under §1.6045-1(n)(4)**

| | Election | Underlying Rule | Effect of affirmative election | Defaults & Applicability |
|---|---|---|---|---|
| i | Election to amortize **bond premium** | section 171 and §1.171-4 | May be amortized, in which case constant yield must be used | Assume elected<br>Revocable<br>Apply to all debts held |
| ii | Election to currently include accrued **market discount** | section 1278(b) | May be included each year or recognized at disposal | Assume unelected<br>Revocable<br>Apply to all debts acquired |
| iii | Election to accrue **market discount** based on a **constant yield** | 1276(b)(2) | May use constant yield or ratable accrual mechanism | Assume unelected<br>Irrevocable<br>Apply to identified debts |
| iv | Election to treat all interest as **OID** | §1.1272-3 | May treat all bonds as OID bonds | Assume unelected<br>Revocable<br>Apply to identified debts |
| v | Election to **translate interest** income and expense at the spot rate | §1.988-2(b)(2)(iii)(B) | Not applicable yet in Phase III, since non-USD bonds are not yet covered | Assume unelected<br>Revocable<br>Apply to all debts held |
| | Required: **OID** must be accrued | 1272 | OID must always be accrued, generally, using constant yield or the IRS supplied accrual tables. | |
| | Required: **Acquisition premium** must be accrued, although investor can choose method | §1.1272-2(a) | Acquisition premium must always be accrued, although a few methods are available | |

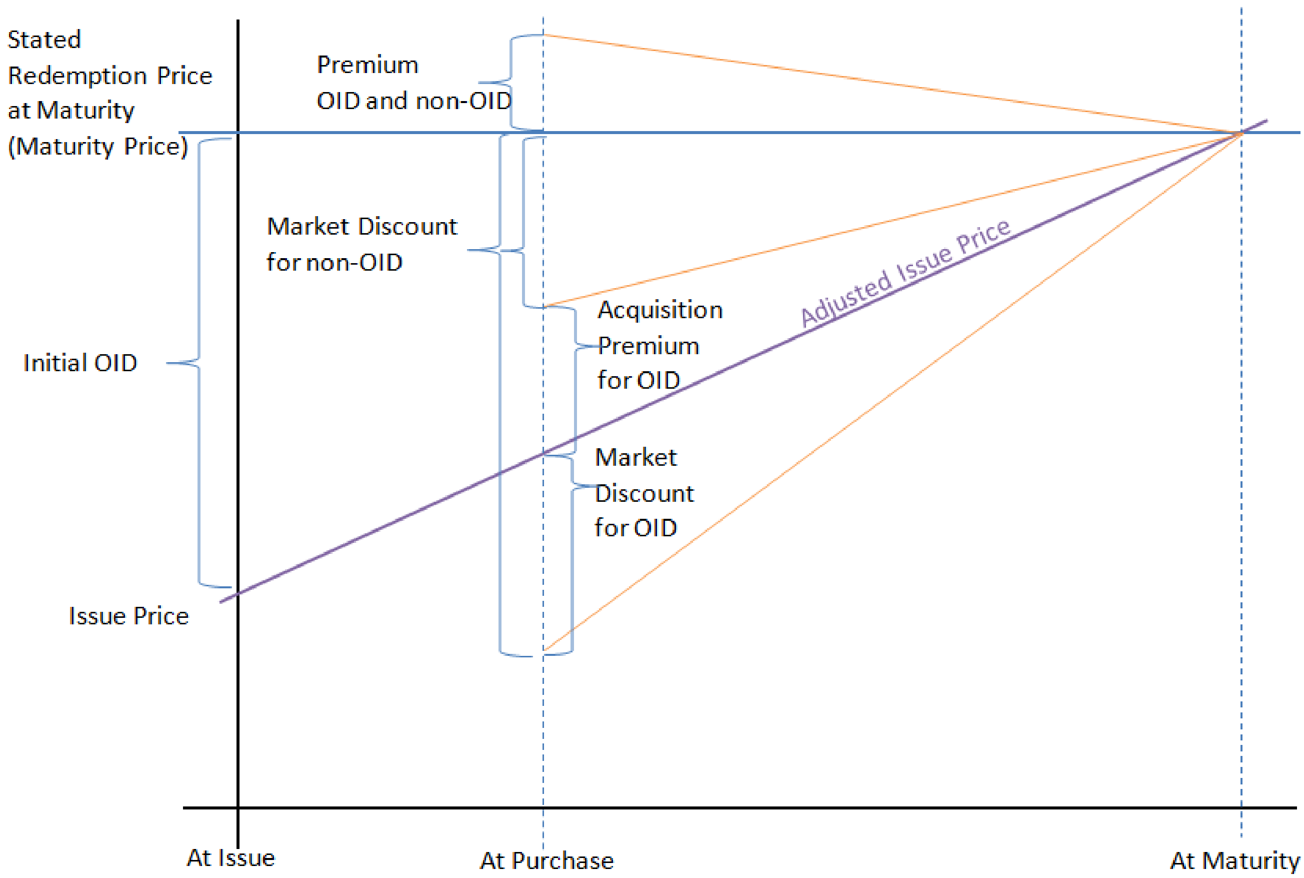
If the taxpayer wishes to revoke any of elections (i), (ii), (iv), and (v), this requires consent of the IRS commissioner. Election (v) is ignored from this point on because it does not apply in Phase III.

## REVIEW OF PREMIUM, DISCOUNT, AND OID

Phase III does not change the regulations governing bond amortization, and this paper is not a discussion on this topic. However, some understanding of amortization is needed to understand how to prepare the relevant 1099 forms. Graph 1 is a representation of various common terms needed in discussing bond amortization.

**Graph 1 - Components of Bond Amortization**

The x-axis measures time and the y-axis measures price, the two determining factors in bond amortization.




At the time of issue, a bond is an OID bond if the issue price is less than the maturity price (with a de minimis exception). If the bond is issued at maturity price or higher (again with a de minimis rule), it is a non-OID bond. An interest may be qualified stated interest or not qualified stated interest. Qualified stated interest is unconditional interest paid at least once a year at a fixed rate. For Phase III, we can safely assume qualified stated interest and interest are practically the same. We may use “qualified stated interest” for emphasis.

For every OID bond, there must exist an adjusted issue price. This is a computable price that gradually increases from the time it is issued until maturity. In Graph 1, we assume a linear accrual, aka ‘ratable’ accrual. The constant yield method is required for all debts issued post 1984. An OID bond can fall into 1 of 5 scenarios depending on its purchase price, these are listed below starting with the simplest case. In most cases, 1099-OID must be used and 1099-INT *may* be used.

1. **Purchase Price = Adjusted Issue Price**. For example, the OID bond was bought at the issue price when it was issued. In this case the bond has OID. The OID must be accrued and reported on 1099-OID. Qualified stated interest, if any, may be reported on the 1099-OID or 1099-INT.
2. **Purchase Price = Maturity Price**. This should be rare. But in this case, the bond has no OID. Qualified stated interest, if any, may be reported on 1099-OID or 1099-INT.
3. **Purchase Price > Maturity Price**. Effectively the bond is non-OID. It instead has bond premium, which may or may not be amortized. If it is amortized, it offsets interest. Since the bond has no OID, both the premium and any interest may be reported on 1099-INT. The premium may be reported separately or netted against interest.
4. **Adjusted Issue Price < Purchase Price < Maturity Price**. The bond has OID and acquisition premium. Acquisition premium offsets OID. Both must be accrued and reported on 1099-OID. Qualified stated interest, if any, may be reported on the 1099-OID or 1099-INT.
5. **Purchase Price < Adjusted Issue Price**. The bond has OID and market discount. Market discount may or may not be accrued. If it is accrued, it acts as interest income. Both must be reported on 1099-OID. Qualified stated interest, if any, may be reported on 1099-OID or 1099-INT.

A non-OID bond can fall into 1 of 3 scenarios depending on its purchase price. Use only 1099-INT.
1. **Purchase Price = Maturity Price**. Interest must be reported on 1099-INT.
2. **Purchase Price > Maturity Price**. The bond has bond premium, which may or may not be amortized. If it is amortized, it offsets interest. Both the premium and interest may be reported on 1099-INT. The premium may be reported separately or netted against interest.
3. **Purchase Price < Maturity Price**. The bond has market discount. Market discount may or may not be accrued. If it is accrued, it is treated as interest income. Both the market discount and the interest may be reported 1099-INT.

Because these scenarios are mutually exclusive, at any one time for any one bond, at most one of premium, acquisition premium, or market discount is non-zero.

For Phase III, if a broker does not hear back from a customer, the broker can assume the customer positively elected (i) to amortize bond premium and negatively elected (ii) to (iv). The broker must still report OID, acquisition premium, and of course interest income. Table 9 is a quick reference chart on how each item should be reported.

**Table 9 - Reference Chart on Reporting OID, acquisition premium, and interest income**

| Item | Election to include based on: | If included, calculate using: | If included & from OID, use | If included & from non-OID, use |
|---|---|---|---|---|
| Premium | section 171 or §1.171-4 | §1.171-1 constant yield | 1099-INT | 1099-INT |
| Market Discount | section 1278(b) | 1276(b)(1) ratable or 1276(b)(2) constant yield | 1099-OID | 1099-INT |
| **Item** | **Required to include based on:** | | **If from OID, use** | **If from non-OID, use** |
| Interest | §1.61-7 | | 1099-INT or 1099-OID | 1099-INT |
| OID | section 1272(a) or §1.1272-1(b)(1) | | 1099-OID | NA |
| Acquisition Premium | section 1272(a)(7) or §1.1272-2(a) | | 1099-OID | NA |

In addition, a 1099-B form must be filled out for each closing transaction that occurred in the year.  Finally, let us go over some examples.

**Example 7 – The same bond portfolio reported under different elections**

In the following, redemption price for all bonds is $100 per bond and price is net of accrued interest, that is, the "clean price."

On 01/01/2014, purchase $10,000 face value of OID bond AAA at $90 (which is also the adjusted issue price setting a cost basis of $9,000).
On 03/01/2014, purchase $10,000 face value of bond SSS at $105
On 05/01/2014, purchase $10,000 face value of bond TTT at $99
On 07/01/2014, purchase $10,000 face value of zero-coupon bond BBB at $80, which is above the adjusted issue price

At year end 12/31/2014, we see the following:
AAA has paid a $1 coupon ($100 total) and accrued $0.70 in OID
SSS has paid a $5 coupon and accrued $0.50 in premium amortization
TTT has paid $4 coupon and accrued $0.30 in market discount using constant yield
BBB has paid no coupons, but has accrued $1.20 in OID and $0.18 in acquisition premium amortization

We have 3 customers each with the exact same portfolio.
**Customer 1** did not make any election
**Customer 2** elects not to amortize premium and not to include market discount
**Customer 3** elects to amortize premium and to include market discount, using constant yield
How does the broker report for these customers?

Since customer 1 did not make any election, the default is to amortize premium and not include market discount.  For all customers, the broker must file two 1099-OID and one 1099-INT.  OID bonds with only OID and acquisition premium are not affected by client elections under Phase III, so the same two forms apply to all customers (Tables 10A and 10B).  Interest Income is the same for all customers.  In this case it is 100 * $5 + 100 * $4 = $900.  But 1099-INT is affected by client election and differs for each (Tables 10C, 10D, and 10E).

| **Table 10A - The same bond portfolio reported under different elections: form 1099-OID for AAA** | | |
|---|---|---|
| Box 1 is 10,000 / 100 * $0.70 = $70.<br>Box 2 is 10,000 / 100 * $1.00 = $100.<br>The broker may report the $100 of other period interest on a separate form 1099-INT instead.  In our example we report both accrued OID and interest payment for AAA on one 1099-OID. | 1 Original issue discount for 2014<br>**$70** | |
| | 2 Other periodic interest<br>**$100** | |
| | 3 Early withdrawal penalty<br>**$0** | 4 Federal Income tax withheld<br>**$0** |
| | 5 Market discount<br>**$0** | 6 Acquisition premium<br>**$0** |
| | 7 Description<br>**OID bond AAA** | |
| | 8 Original issue discount on US Treasury obligations<br>**$0** | |
| | 9 Investment expenses<br>**$0** | |

| Table 10B - The same bond portfolio reported under different elections: form 1099-OID for BBB | | |
|---|---|---|
| Box 1 is 10,000 / 100 * $1.20 = $120.<br>Box 6 is 10,000 / 100 * $0.18 = $18.<br>Note that acquisition premium is used to offset OID (i.e., reduces tax liability). | 1 Original issue discount for 2014<br>**$120** | |
| | 2 Other periodic interest<br>**$0** | |
| | 3 Early withdrawal penalty<br>**$0** | 4 Federal Income tax withheld<br>**$0** |
| | 5 Market discount<br>**$0** | 6 Acquisition premium<br>**$18** |
| | 7 Description<br>**OID bond BBB** | |
| | 8 Original issue discount on US Treasury obligations<br>**$0** | |
| | 9 Investment expenses<br>**$0** | |

| Table 10C - 1099-INT for Customer 1 | Table 10D - 1099-INT for Customer 2 |
|---|---|
| Bond Premium is 10,000 / 100 * $0.50 = $50. The broker may net the $50 by entering $850 in box 1 and $0 in Box 11. | Only the interest income is filled in. Both Market Discount and Bond Premium are set to $0 by the customer's election. |

**Table 10C - 1099-INT for Customer 1**

| | |
|---|---|
| 1 Interest Income<br>**$900** | |
| 2 Early withdrawal penalty<br>**$0** | |
| 3 Interest on US Savings Bonds and Treasury obligations<br>**$0** | |
| 4 Federal Income Tax withheld<br>**$0** | 5 Investment expenses<br>**$0** |
| 6 Foreign tax paid | 7 Foreign country or US possession |
| 8 Tax-exempt interest<br>**$0** | 9 Specified private activity bond interest<br>**$0** |
| 10 Market discount<br>**$0** | 11 Bond premium<br>**$50** |

**Table 10D - 1099-INT for Customer 2**

| | |
|---|---|
| 1 Interest Income<br>**$900** | |
| 2 Early withdrawal penalty<br>**$0** | |
| 3 Interest on US Savings Bonds and Treasury obligations<br>**$0** | |
| 4 Federal Income Tax withheld<br>**$0** | 5 Investment expenses<br>**$0** |
| 6 Foreign tax paid | 7 Foreign country or US possession |
| 8 Tax-exempt interest<br>**$0** | 9 Specified private activity bond interest<br>**$0** |
| 10 Market discount<br>**$30** | 11 Bond premium<br>**$0** |

| Table 10E - 1099-INT for Customer 3 | | |
|---|---|---|
| Bond Premium is $0 by customer election.<br><br>Market discount is 10,000 / 100 * $0.30 = $30 and is entered as a positive number | 1 Interest Income<br>**$900** | |
| | 2 Early withdrawal penalty<br>**$0** | |
| | 3 Interest on US Savings Bonds and Treasury obligations<br>**$0** | |
| | 4 Federal Income Tax withheld<br>**$0** | 5 Investment expenses<br>**$0** |
| | 6 Foreign tax paid | 7 Foreign country or US possession |
| | 8 Tax-exempt interest<br>**$0** | 9 Specified private activity bond interest<br>**$0** |
| | 10 Market discount<br>**$30** | 11 Bond premium<br>**$0** |

**Example 8 – Example 7 with Sales**
We have the same customers and portfolio from Example 6:
On 01/01/2014, purchase $10,000 face value of OID bond AAA at $90
On 03/01/2014, purchase $10,000 face value of bond SSS at $105
On 05/01/2014, purchase $10,000 face value of bond TTT at $99
On 07/01/2014, purchase $10,000 face value of OID bond BBB at $80, which is above the adjusted issue price.
The investor now makes these trades in 2015. Prices are net of accrued interest, that is “clean price.”
On 02/01/2015, sell the SSS position at $103. For 2015, accrued interest is $0.40. SSS also has $0.04 in premium amortization.
On 07/05/2015, sell the AAA position at $92. For 2015, AAA accrued $0.40 in OID and $0.55 in accrued interest.

For the year ending on 12/31/2015, we see:
TTT has paid a $4 coupon and accrued $0.33 in market discount using constant yield
BBB paid no coupons, but has accrued $1.25 in accrued OID and $0.20 in acquisition premium amortization.
The broker must fill out two 1099-OID, two 1099-B, and one 1099-INT, for a total of five forms.

<u>Customer 1</u>

**Table 11A - 1099-B for SSS sale**

The loss is short-term. The accrued interest is reported on 1099-INT. The proceeds is the sales price multiplied by the shares. The basis is the original purchase price reduced by premium amortization of $105 – ($0.50+$0.04) = $104.46, multiplied by the shares

| | |
|---|---|
| Applicable check box on Form 8949<br>A | |
| 1a Description of property (Example 100 sh.XYZ Co.)<br>$10,000 face value of SSS | |
| 1b Date Acquired<br>3/1/2014 | 1c Date sold or disposed<br>2/1/2015 |
| 1d Proceeds<br>$10,300 | 1e Cost or other basis<br>$10,446 |
| 1f Code, if any | 1g Adjustments |
| 2 Type of gain or loss:<br>Short-term X<br>Long-term | 3 Check if basis reported to IRS<br>X |
| 4 Federal income tax withheld<br>$0.00 | 5 Check if non-covered security |
| 6 Reported to IRS:<br>Gross proceeds X<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |

**Table 11B - 1099-B for AAA sale**

The gain is long-term. The proceeds is the sales price multiplied by the shares. The basis of the bond is the original purchase price increased by OID of $90 + ($0.70+$0.40) = $91.10, multiplied by the shares. The accrued OID and interest are reported on 1099-OID.

| | |
|---|---|
| Applicable check box on Form 8949<br>D | |
| 1a Description of property (Example 100 sh.XYZ Co.)<br>$10,000 face value of AAA | |
| 1b Date Acquired<br>1/1/2014 | 1c Date sold or disposed<br>7/5/2015 |
| 1d Proceeds<br>$9,200 | 1e Cost or other basis<br>$9,110 |
| 1f Code, if any | 1g Adjustments |
| 2 Type of gain or loss:<br>Short-term<br>Long-term X | 3 Check if basis reported to IRS<br>X |
| 4 Federal income tax withheld<br>$0.00 | 5 Check if non-covered security |
| 6 Reported to IRS:<br>Gross proceeds X<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |

In the interest of saving space, we won't reproduce the full 1099-INT and 1099-OID but we will include instructions on how we arrived at our calculations.

For the 1099-INT:
Box 1 Interest Income is $40 accrued from SSS + $400 from TTT = $440
Box 10 Market Discount is $0 due to customer election
Box 11 Bond Premium is ($4) from SSS.
For the 1099-OID for AAA, Box 1 OID is $40 and Box 2 Other Interest is $55
For the 1099-OID for BBB, Box 1 OID is $125 and Box 6 Acquisition Premium is ($20)

Customer 2

| Table 11C - 1099-B for the SSS sale | | |
|---|---|---|
| 1099-B for the AAA sale is the same as for Customer 1<br>1099-B for the SSS sale is to the right. The basis is the original purchase price.<br><br>For the 1099-INT:<br>Box 1 Interest Income is the same as for Customer 1: $440<br>Box 10 Market Discount is $0 due to customer election<br>Box 11 Bond Premium is $0 due to customer election<br>1099-OID for SSS is the same as for Customer 1<br>1099-OID for TTT is the same as for Customer 1 | Applicable check box on Form 8949<br>**A** | |
| | 1a Description of property (Example 100 sh.XYZ Co.)<br>**$10,000 face value of SSS** | |
| | 1b Date Acquired<br>**3/1/2014** | 1c Date sold or disposed<br>**2/1/2015** |
| | 1d Proceeds<br>**$10,300** | 1e Cost or other basis<br>**$10,500** |
| | 1f Code, if any | 1g Adjustments |
| | 2 Type of gain or loss:<br>Short-term **X**<br>Long-term | 3 Check if basis reported to IRS<br>**X** |
| | 4 Federal income tax withheld<br>**$0.00** | 5 Check if non-covered security |
| | 6 Reported to IRS:<br>Gross proceeds **X**<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |

Customer 3

1099-B for the AAA sale is the same as for Customer 1
1099-B for the SSS sale is the same as for Customer 1
For the 1099-INT:
Box 1 Interest Income is the same as for Customer 1: $440
Box 10 Market Discount is $33
Box 11 Bond Premium is ($4)
1099-OID for SSS is the same as for Customer 1
1099-OID for TTT is the same as for Customer 1

**Example 9 - Sale with market discount**
A customer elects not to include Market Discount and to accrue Market Discount using constant yield. He makes this purchase.

On 05/01/2014, purchase $10,000 face value of bond TTT at $99
On 12/31/2014, the customer sells the bond at $100. During the holding period, $0.33 has accrued in market discount.

The broker has to file a 1099-INT and a 1099-B (Table 12). We provide an example for the 1099-B.

**Table 12 - Sale with market discount**

| | | |
|---|---|---|
| Boxes 1d and 1e are just the sale and purchase price.<br><br>Box 1f is D for Market Discount<br>Box 1g is $33 to reflect the accrued market discount | Applicable check box on Form 8949<br>D | |
| | 1a Description of property (Example 100 sh.XYZ Co.)<br>**$10,000 face value of AAA** | |
| | 1b Date Acquired<br>**5/1/2014** | 1c Date sold or disposed<br>**12/31/2014** |
| | 1d Proceeds<br>**$10,000** | 1e Cost or other basis<br>**$9,900** |
| | 1f Code, if any<br>**D** | 1g Adjustments<br>**$33** |
| | 2 Type of gain or loss:<br>Short-term **X**<br>Long-term | 3 Check if basis reported to IRS<br>**X** |
| | 4 Federal income tax withheld<br>**$0.00** | 5 Check if non-covered security |
| | 6 Reported to IRS:<br>Gross proceeds **X**<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |

### Example 10 – Change in election over time

An investor buys a non-OID bond with 10 years left to mature at a price of $90,000 with a redemption price of $100,000. The customer elects to accrue market discount using a constant yield that calculates to 1.0592%. For the sake of example the customer elects not to include market discount in income for years 1, 2, 6, and 7; he elects to include market discount for the other years of 3, 4, 5, 8, 9, and 10.

How should the broker report this? To do this, the broker would have to have a fully amortized schedule of the bond. Table 13 shows this schedule:

**Table 13 - Fully amortized bond schedule**

| Year | Fully Amortized Basis | Accrued Market Discount | Customer Election | Customer's Reported Basis | |
|---|---|---|---|---|---|
| 1 | 90,953 | 953 | Do not Include | 90,000 | If the customer elects not to include market discount, then the basis at this year-end is the basis from last year-end.<br><br>If the customer elects to include market discount, the basis at this year-end is the basis from last year-end increased by what would have accrued this year if the customer fully amortized.<br><br>In this example, the basis at the end of year 3 is the basis at end of year 2 (90,000), increased by what the accrued market discount would have been had the bond been fully amortized (974). This works out to be $90,974. |
| 2 | 91,917 | 963 | Do not Include | 90,000 | |
| 3 | 92,890 | 974 | Include | 90,974 | |
| 4 | 93,874 | 984 | Include | 91,957 | |
| 5 | 94,868 | 994 | Include | 92,952 | |
| 6 | 95,873 | 1,005 | Do not Include | 92,952 | |
| 7 | 96,889 | 1,015 | Do not Include | 92,952 | |
| 8 | 97,915 | 1,026 | Include | 93,978 | |
| 9 | 98,952 | 1,037 | Include | 95,015 | |
| 10 | 100,000 | 1,048 | Include | 96,063 | |

## Section 7: USE UNADJUSTED COST TO AMORTIZE WHEN INTERACTING WITH WASH SALES

Consider two scenarios.

| | |
|---|---|
| Day 1 Buy a bond at $100 | Day 1 Buy a bond at $100 |
| Day 2 Sell the bond at $90 | Day 2 Buy the bond at $95 |
| Day 3 Buy the bond at $95 | Day 3 Sell the bond at $90 |

In both scenarios, a wash sale is generated with a $10 disallowed loss. How does this disallowed loss impact amortization?

In the BBS case, it is a compelling case to use the unadjusted $95 as the basis of the bond. Regulations 1.1272-2(b)(2) and (3), 1.171-1(d)(1), and section 1278(a)(2)(A)(ii) all use the term "the basis of such bond immediately after its acquisition by the taxpayer." Clearly the sell, which happens the next day, does not fall into that "immediately" window.

What about the BSB case, where the sell leg has already occurred before the replacement buy? In this case the text is unclear. However, we believe we can still use the unadjusted price of $95, rather than an adjusted $105. Here's why:

The text does not preclude us from using the unadjusted price. While the amortization rules introduce the element of time by using "immediately after," the wash sale rule does not even mention time. One might view this as amortization takes effect first, since "immediately after" is used. Or one might view this as wash sale takes effect first, since wash sale transcends time by not even mentioning time.

For wash sale purposes, BBS = BSB. It would be consistent to assume this commutative property would apply in amortization as well. If we were to use the adjusted basis, it could fundamentally change the nature of a bond and could partially defeat the spirit of the Wash Sale rule. For example we have an investor who elects to minimize tax, which means he amortizes premium annually, but delays recognizing market discount until disposition. His basis (Table 14) will look like the following:

**Table 14 - Basis for BBS and BSB**

| BBS | | BSB | | |
|---|---|---|---|---|
| Year | Basis | Year | Basis | Amortized Premium |
| 1 | 95,000 | 1 | 104,489 | (511) |
| 2 | 95,000 | 2 | 103,980 | (509) |
| 3 | 95,000 | 3 | 103,474 | (506) |
| 4 | 95,000 | 4 | 102,971 | (504) |
| 5 | 95,000 | 5 | 102,470 | (501) |
| 6 | 95,000 | 6 | 101,971 | (499) |
| 7 | 95,000 | 7 | 101,474 | (496) |
| 8 | 95,000 | 8 | 100,981 | (494) |
| 9 | 95,000 | 9 | 100,489 | (491) |
| 10 | 95,000 | 10 | 100,000 | (489) |

By using the adjusted basis, the BSB case produces a bond purchased at a premium (whereas the BBS case, which uses the unadjusted basis, still keeps the bond at a discount). The annual amortization of the premium actually allows back some of the losses that should have been disallowed. While this effect is spread out over time, it still contradicts the spirit of the Wash Sale rule, which is to delay all loss recognition until the bond is disposed of.

Thus we find it defensible to always use the unadjusted basis for all configurations of wash sales.

**Example 11 – Bonds with wash sale**

01/01/2014 Buy 100 bond CCC at $100 a share
01/02/2014 Sell the 100 bond CCC at $90, with an accrued interest of $0.02 a share
01/03/2014 Buy 100 bond CCC at $95 a share

At the end of the year, CCC pays $5 a share in interest and has accrued market discount of $1.20 a share. The client elects to include market discount. Tables 15A and 15B illustrate what the year-end reporting should look like.

**Table 15A - Bonds with wash sale -- Form 1099-INT**

Interest Income is the accrued interest plus the paid interest, or $2 + $500 = $502.
Market discount is included and is $120.

| | |
|---|---|
| 1 Interest Income<br>**$502** | |
| 2 Early withdrawal penalty<br>**$0** | |
| 3 Interest on US Savings Bonds and Treasury obligations<br>**$0** | |
| 4 Federal Income Tax withheld<br>**$0** | 5 Investment expenses<br>**$0** |
| 6 Foreign tax paid | 7 Foreign country or US possession |
| 8 Tax-exempt interest<br>**$0** | 9 Specified private activity bond interest<br>**$0** |
| 10 Market discount<br>**$120** | 11 Bond premium<br>**$0** |

**Table 15B - Bonds with wash sale -- Form 1099-B**

All the boxes should be self-explanatory except for Boxes 1f and 1g.
Box 1f we enter W for wash sales.
Box 1g we enter $1,000, which is disallowed due to the wash sales. When the CCC bond is eventually sold without triggering another wash sale, the $1,000 is added to the cost basis then.

| | |
|---|---|
| Applicable check box on Form 8949<br>**A** | |
| 1a Description of property (Example 100 sh.XYZ Co.)<br>**$10,000 face value of CCC** | |
| 1b Date Acquired<br>**January 1, 2014** | 1c Date sold or disposed<br>January 2, 2014 |
| 1d Proceeds<br>**$9,000.00** | 1e Cost or other basis<br>**$10,000.00** |
| 1f Code, if any<br>**W** | 1g Adjustments<br>**$1,000.00** |
| 2 Type of gain or loss:<br>Short-term **X**<br>Long-term | 3 Check if basis reported to IRS<br>**X** |
| 4 Federal income tax withheld<br>**$0.00** | 5 Check if non-covered security |
| 6 Reported to IRS:<br>Gross proceeds **X**<br>Net proceeds | 7 Check if loss is not allowed based on amount in 1d |

## Section 8: CONCLUSION

CBR Phase III does create substantial reporting burdens for brokers. However, the rules are not nearly as daunting if one follows the detail of the regulations.

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[1] Table 4.3 in IRS publication 550. No particular reason is given, but logically, long a call or short a put is like a long, hence adjust basis. Short a call or long a put is like a short, hence adjust proceeds.

[2] A yield is defined if it can be calculated by applying §1.1272-1(b), (c), or (d).



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