UBS

Understanding the new cost basis reporting rules

Highlights

- Due to legislation enacted by the U.S. Congress, all brokerage firms, including UBS, are now required to report cost basis information on certain securities to the Internal Revenue Service (IRS) as part of their annual tax reporting process.
- As of January 1, 2011, the information captured by UBS, including adjusted cost basis for the sale of equities acquired on or after that date, will be reported to the IRS.
- Starting on January 1, 2012, the cost basis we capture for mutual funds will be reported to the IRS. This applies to mutual funds that qualify as regulated investment companies (RICs) acquired on or after that date.

What is cost basis reporting?

Congress enacted the cost basis reporting rules in 2008, requiring brokerage firms to determine and maintain the cost basis on certain securities.

This brief summary is intended to provide you with an overview of cost basis reporting and how it might impact you. This document is not intended to capture every aspect of the new law nor is it intended as tax advice; please consult your tax advisor regarding your specific situation.

How is cost basis determined?

For certain specified securities, firms are now required to determine and maintain cost basis information and report it to both the Internal Revenue Service (IRS) and to you when those securities are sold or otherwise disposed. In general, your cost basis starts with the original acquisition price and is then adjusted (if necessary) for corporate actions (e.g., stock splits, return of capital distributions, mergers and other events) and wash sales. Your adjusted cost basis is then used to calculate gain or loss versus the sales proceeds on the sale or disposition of those securities.

This information will be reported to the IRS on a newly redesigned Form 1099-B ("Proceeds from Broker and Barter Exchange Transactions") for 2011 and to you on a new Substitute Form 1099-B.

For cost basis reporting purposes, brokerage firms are also required to report whether the gains and losses on securities sold are short- or long-term capital gains and losses. The 2011 Form 1099-B will include columns to capture the additional data.

Cost basis reporting is required for specified securities that are purchased or acquired on or after three different effective dates, as follows:

Effective Date	*Specified Security*
January 1, 2011	Equities (shares in a corporation, including shares in both U.S. and foreign corporations, as well as ADRs (American Depositary Receipts))
January 1, 2012	Mutual Fund shares that are eligible for average cost basis (e.g., shares in a regulated investment company (RIC))
January 1, 2013	Any note, bond, debenture, or other evidence of indebtedness; Any commodity, contract or derivative (e.g., options) with respect to securities or commodities, but only if the IRS determines that it is appropriate to report cost basis on these securities or commodities.

Covered and non-covered securities

Those specified securities that are purchased or acquired on or after the effective date are defined as "covered," and those purchased or acquired before the effective date are defined as "non-covered." Non-covered securities also include those securities that were transferred into your brokerage account from another firm without cost basis reporting information. The prior

IRS rule requiring a firm to report only the gross proceeds of sales still applies to non-covered securities.

Based on the new requirements, your 2011 Form 1099-B will include the gross proceeds of sales and the adjusted cost basis of equity shares that were purchased or acquired and subsequently sold in 2011. It may also include the gross proceeds of sales of non-covered securities as well.

Wash sales
Firms are now required to calculate wash sale adjustments for covered securities. A wash sale is defined as selling a security at a loss and purchasing the same stock 30 days before or after the trade.

The wash sale rules require realized losses incurred upon sales to be deferred and added to the basis of replacement securities acquired within a certain period of those sales. The holding period of the replacement securities must also be adjusted. Although taxpayers are required to report wash sales, brokerage firms may use a "simplification rule" that limits the scope of wash sale adjustments to transactions occurring in the **same account** involving **identical securities** (e.g., same CUSIP).

Although brokerage firms are able to apply simplified rules for calculating wash sale adjustments, taxpayers remain responsible for considering the broader set of rules under IRC Section 1091 (applying this rule to substantially identical securities across all accounts) and potentially reporting additional wash sale adjustments on their tax returns.

Tax lots and lot relief methods
Separate positions in the same security in your account are defined as "tax lots." In other words, tax lots represent those account positions with a unique purchase date and cost basis.

When multiple tax lots are available to be sold or transferred, clients may elect a "lot relief method" established by a standing instruction to dispose of those lots. The lot relief method essentially establishes an ordering mechanism for removing shares from an account when sold or transferred. If a lot relief method is not selected, firms are required to treat them as First In First Out (FIFO). (*See page 3 for more information.)*

Average cost basis
The average cost basis election is only allowed for mutual fund shares and qualified Dividend Reinvestment Plans. Clients must make an affirmative election in writing to use average cost basis. For this purpose, "in writing" includes electronic communications. Your written election must identify each account and the security in the account for which average cost basis is to be applied.

Clients may revoke their average cost basis election back to the date of original election (basis is original basis before election), but can only do so up until one year after the initial election or until the date of first sale or transfer, whichever is earlier.

- Note that clients can change from their average cost basis election to another method prospectively at any time (basis of each share remains the same as immediately before change or the average cost per share).
- Like the election, the revocation or change from average cost basis must be made in writing.
- Also note that a method of specifically identifying the lot to be sold is not permitted while the average basis method is in effect.
- The order of lots sold or transferred under the average method will always be FIFO.

Short sales
While the older rules for completing Form 1099-B required the reporting of the gross proceeds of short sales on the date of opening, the new cost basis reporting rules generally require the reporting of gain or loss when the short sale is closed.

Transferred securities
Beginning on January 1, 2011 when transferring between brokerage accounts, transferring firms are required to provide transfer statements to receiving firms indicating whether the securities are covered, along with any relevant cost basis information. If transferring firms provide the receiving firm with the required information, the cost basis will be maintained and reported on covered securities when sold. Likewise, for securities that are transferred out of your accounts, the transferring firm will send a transfer statement indicating whether the securities are covered and any relevant cost basis information.

Transfers of gifted and inherited securities
For gifted securities, brokerage firms are required to consider the donor's carryover basis and date of acquisition, along with the fair market value of the security on the date of the gift. For covered securities, this information is to be used in both transfer statements and in determining the donee's cost basis of the gifted securities.

For inherited securities, the transferring firm is required to report the fair market value of the security on the decedent's date of death on the transfer statement. This is the rule unless the estate's representative provides the brokerage firm with instructions to use other information (e.g., if the estate elects to use the alternative valuation date which is six months after the date of death). The IRS allows the transferring firm to treat it as non-covered if neither knows nor can "readily ascertain" the fair market value of the security on the date of death. In all cases, the transferring firm is required to indicate on transfer statements that the security was inherited.

Substitute Form 1099-B
As in prior years, brokerage firms may send clients a Substitute Form 1099-B. This Substitute Form 1099-B is provided in a statement format and will include new columns required by the IRS: your cost basis on covered securities, the wash sale loss disallowed, the type of gain or loss (e.g., short-term or long-term), whether the security is covered, and whether certain losses are disallowed. Clients may still reconcile any differences and other adjustments on their individual tax returns.

In addition to the Substitute Form 1099-B, UBS will provide a Schedule of Realized Gains and Losses, however, this information is not reported to the IRS. Based on the new IRS requirements, your Schedule of Realized Gains and Losses is organized into five separate sections that conform with the new IRS Form 8949:

1. Short-Term Transactions for Which Basis Was Reported to the IRS; Report on Form 8949, Part I, with Box A checked.
2. Short-Term Transactions for Which Basis Was Not Reported to the IRS; Report on Form 8949, Part I, with Box B checked.
3. Long-Term Transactions for Which Basis Was Reported to the IRS; Report on Form 8949, Part II, with Box A checked.
4. Long-Term Transactions for Which Basis Was Not Reported to the IRS; Report on Form 8949, Part II, with Box B checked.
5. Transactions for Which Basis Was Not Reported to the IRS and for Which Short- or Long-Term Determination is Unknown (to Broker); Report on Form 8949 with Box B checked, in either Part I or Part II as appropriate.

The new law requires firms to provide corrected Forms 1099-B for three years. Corrections could be the result of amended corporate actions, corrected transfer statements from other firms, and other events that could result in the need to file a corrected Form 1099-B and may cause you to consider filing an amended tax return for the year that was corrected.

Changes you will see on UBS Online Services related to cost basis reporting
We have enhanced the way we display your tax lots in UBS Online Services.

In addition to displaying "WS" to indicate a wash sale, each tax lot is identified with a superscript number that indicates one of the following:

- The cost basis information was received from an Automated Customer Account Transfer (ACAT) – provided by a source other than UBS.
- The tax lot has been adjusted by UBS (other than a wash sale).

The tax lot pages also contain the following:

- A new column," Reported by UBS to IRS," indicates a reportable (covered) versus a non-reportable (uncovered) tax lot.
- Another new column, "Method," indicates the order to be used when selling tax lots of the same security. The options are:

  - First In First Out (FIFO) – selling the tax lots that were purchased or opened first
  - Last In First Out (LIFO) – selling the tax lots that were purchased or opened most recently
  - Highest In First Out (HIFO) – selling the tax lots that were purchased or opened at the highest cost
  - Versus Purchase (VSP) – allowing you to select specific tax lots that you would like to partially or fully sell

Note that you are permitted to change your lot relief method at any time; however, the method you choose must be determined before the transaction settles.

Both the unrealized and realized equity tax lots are updated daily as needed during trading hours.

After entering the "Trading" tab in Online Services, clients who are eligible for Online Trading can access information on how the new cost basis requirements impact the way transactions are displayed and completed.

Statements
An enhanced "Realized gain/loss adjustment" section on account statements indicates why an adjustment was made to a previously reported tax lot. For example:

- Trade cancellation
- Previously missing cost basis
- Wash sale

We have changed the way price per share for equities is displayed. The price now includes the commission and fees associated with the purchase of the security.

Trade confirmations
Trade confirmations have been enhanced to:

- Display an unlimited number of tax lots.
- Reflect all tax lots if a method other than FIFO was selected.

Changes you will see on your UBS Form 1099-B and Realized Gains and Losses for tax year 2011
We have enhanced our Form 1099-B to include adjusted cost basis information and made other improvements to simplify your tax reporting. The new UBS forms mirror the IRS tax form for improved readability and

understanding and will allow you to easily map and transfer the information from UBS's forms to the new IRS forms.

Questions and additional information
Please contact your Financial Advisor with questions or visit *www.ubs.com/costbasis* for more information.

Disclosure
This summary description of the new cost basis reporting rules is not tax advice. Clients should not rely on this summary to avoid any penalties potentially imposed by any taxing jurisdiction. Please consult with your tax advisor regarding this new law and it implications upon your specific situation.

UBS Financial Services Inc. is a subsidiary of UBS AG.